



**U. S. Department of Agriculture
Office of Inspector General
Audit Report**

Forest Service
Audit of Fiscal Year 1997
Financial Statements

Audit Report
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EXECUTIVE SUMMARY

Purpose

The Chief Financial Officers (CFO) Act of 1990, requires the annual preparation and audit of Federal financial statements. The purpose of the audit is to determine whether the Statement of Financial Position and Statement of Operations and Changes in Net Position (Financial Statements) present fairly, in all material respects, the financial position of the Forest Service in accordance with applicable accounting standards. In conjunction with the audit of financial statements, we are required to consider Forest Service's internal control structure to assess whether the agency's plan of organization and adopted methods and procedures were sufficient to ensure that (1) reliable financial information was obtained, maintained, and fairly disclosed in Forest Service's reports and (2) resources were sufficiently safeguarded against waste, loss, and misuse. We are also required to test Forest Service's compliance with laws and regulations which could directly affect the financial statements.

Results in Brief

Due to significant limitations on the scope of our examination, we were unable to express an opinion on the Statement of Financial Position as of September 30, 1997, and the related Statement of Operations and Changes in Net Position for the period then ended. The absence of an integrated general ledger and supporting subsidiary records along with significant financial systems weaknesses prevented us from performing sufficient tests to obtain assurances that amounts reported in the fiscal year (FY) 1997 financial statements were fairly presented.

Our examination of Forest Service's internal control structure disclosed that (1) continuing financial management deficiencies prevented Forest Service from preparing complete, reliable, timely, and consistent financial statements, (2) the lack of an integrated accounting system and material weaknesses within the current system resulted in inaccurate and unreliable financial data, and (3) internal controls were not sufficient to safeguard assets or to ensure that field level financial records were accurate.

On April 28, 1998, the Secretary of Agriculture and the Forest Service Chief issued press releases announcing major actions to address serious accountability and financial management problems to include

- establishing an organization with "clear accountability for both program and management objectives,"
- making sure that Forest Service has sufficient resources to address management problems, and
- filling key leadership positions.

Our examination of Forest Service's compliance with laws and regulations disclosed that Forest Service's financial management systems were not in compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). The financial management systems did not have (1) standard data classifications for recording financial events, (2) common processes for processing similar transactions (e.g., two different ledger accounts were used to compute amounts for financing sources from reimbursements), (3) adequate internal controls over data entry, transaction processing, and reporting, and (4) single source data entry (e.g., purchaser road credits, obtained from Automated Timber Sale Accounting (ATSA), are manually input into property ledgers). Also, Forest Service was significantly behind schedule in addressing its Year 2000 conversion project. We also identified deficiencies in the exchange of Federal lands which could result in material losses to the Government. These deficiencies included noncompliance with provisions of the Federal Land Exchange Facilitation Act of 1988, and the Uniform Appraisal Standards for Federal Land Acquisitions.

**Key
Recommendations**

In our report on Forest Service's internal control structure, we recommended that Forest Service

- ensure that sufficient, full-time staff is assigned to compile and complete the financial statements in a timely manner for FY 1998,
- ensure that regions and units adopt and adhere to the agencywide accounting policies and procedures,
- complete the timber revenue reconciliation process,
- ensure timely implementation of the Infrastructure (INFRA) system,
- determine if two different reimbursement revenue accounts are necessary in the general ledger, and, if needed, perform reconciliations to determine why they differ,
- work with the Office of the Chief Financial Officer's National Finance Center (OCFO/NFC) to reconcile fund balances between the general ledger and Treasury records, and fully document the nature of differences,
- implement recommendations in the Coopers & Lybrand study to modify the current management code structure to reduce the risk of noncompliance with "charged as worked" initiatives,
- implement measures to improve supervisory oversight of data input and data cleanup efforts to ensure reliable data is in the accounting system, and

- ensure that property inventories are completed and amounts are properly supported and capitalized in accordance with the \$5,000 capitalization level.

In our report on compliance with laws and regulations, we recommended that Forest Service work with the OCFO/NFC to ensure that financial management systems comply with the FFMIA.

Agency Response

On June 23, 1998, we discussed the issues presented in our reports with agency officials. They generally agreed with the related findings and recommendations.

**REPORT OF THE
OFFICE OF INSPECTOR GENERAL
DISCLAIMER OF OPINION**

TO: Mike Dombeck
Chief
Forest Service

In accordance with the CFO Act of 1990, we were engaged to audit the accompanying Statement of Financial Position of the Forest Service as of September 30, 1997, and the related Statement of Operations and Changes in Net Position for the fiscal year then ended. These Financial Statements are the responsibility of Forest Service's management.

***Material Scope
Limitations***

The absence of an integrated general ledger¹ and supporting subsidiary records along with significant financial systems weaknesses prevented us from performing sufficient tests to obtain assurances that amounts reported in the FY 1997 financial statements were fairly presented in accordance with Federal accounting standards. Our audit efforts were further hampered because of the difficulties in tracing transactions through Forest Service's vast and complex management code system into the central accounting system (CAS) and the general ledger.

***Conditions Impairing
the Scope of Our
Audit***

The following conditions related to Forest Service's assets, liabilities, net equity, revenue, expenses, and changes in net position materially impaired the scope of our review.

ASSETS

For FY 1997, Forest Service reported approximately \$2.9 billion in funds held in 144 different accounts at the U.S. Treasury Department. However, we could not verify fund balances with Treasury because of the numerous adjustments necessary to make agencies' records agree with Treasury records. For FY 1997, OCFO/NFC manually adjusted the U.S. Department of Agriculture's (USDA) agencywide Fund balances with Treasury account by a net of almost \$1 billion to agree with Treasury records without fully researching and reconciling the differences. We could not readily determine the amount of adjustments directly related to Forest Service.

Forest Service does not have reliable account balances for its real property (land, buildings, and roads) which comprises 94.3 percent of the reported \$8.69 billion of property, plant, and equipment. Physical inventories and valuations have not been completed for real property. Forest Service plans to complete the real property inventories and valuations by July 31, 1998.

Additionally, Forest Service made significant changes to and then deviated significantly from its planned

methodology for determining the FY 1997 balance for Property, Plant, and Equipment. On November 13, 1997, the Forest Service informed the Acting Chief Financial Officer that it adopted the Department's new \$100,000 capitalization threshold to be used in reporting the value of real property. However, neither the OCFO nor Forest Service officials had obtained sufficient evidence to justify the change in the capitalization threshold or show that the proposed increase in capitalization level would not materially effect the financial statements. We presented an issue paper to Forest Service and OCFO on December 8, 1997, to express our concerns about the change. On February 6, 1998, representatives from the General Accounting Office (GAO), the Forest Service, the OCFO, and the Office of Inspector General (OIG) met to discuss the issue. At that meeting, it was decided that Forest Service would record real property assets using the original \$5,000 capitalization threshold until the OCFO or Forest Service could support a change in the threshold.

On October 17, 1997, Forest Service transmitted to OCFO/NFC a significant number of adjustments to accounts receivable. The adjustments reflected debits and credits with an aggregate total of \$166.3 million. A Forest Service official stated that Forest Service units were allowed to make the adjustments to correct erroneous yearend balances. Forest Service provided us a universe file prior to the adjustments, and we were not made aware of the adjustments until February 1998 while following up on discrepancies during our accounts receivable confirmation testing and our review of accounts receivable line-items. We attempted to obtain a copy of the Forest Service data file transmission, but found that the file had been overwritten and no longer existed. Because of the significant amount of time which would be necessary to verify the accuracy of the adjustments and the effect on accounts receivable, we did not attempt to perform detailed testing.

LIABILITIES

Forest Service's non-Federal Trust and Deposit liability account balance of approximately \$300 million included amounts of advances due from timber purchasers when the advances were billed. However, the liability should only have included advances that were actually collected. We were unable to perform sufficient testing to determine the amount of an adjusting entry for this liability.

NET EQUITY

Forest Service did not prepare financial statements for FY 1996, and we did not audit FY 1996 transactions. Therefore, we have no basis for reliance on the beginning balances for Net Equity.

Net Equity represents the amount of assets less liabilities. Therefore, the scope limitations described above for the asset and liability

categories also impacted our reliance on the equity balance. Therefore, we were unable to perform sufficient testing to verify the amount reported as Total Net Equity in the Statement of Financial Position.

REVENUE AND FINANCING SOURCES

The October 17, 1997, adjustments of accounts receivable, as discussed in the asset section above, resulted in \$79.9 million of aggregate adjustments to revenue and reimbursements. We were unable to perform sufficient testing of the material adjustments to revenue.

EXPENSES

The general ledger trial balance generated by OCFO/NFC showed a negative balance of \$769 million in depreciation and amortization expense. Forest Service made adjustments to increase the expense account by a total of \$886 million resulting in a positive balance of approximately \$117 million. Even after these adjustments to correct the erroneous postings, negative balances remained in 40 of 75 treasury symbols comprising depreciation and amortization expense. The existence of credit balances in individual treasury symbols demonstrates that all needed adjustments were not made. We were unable to determine the cause of the negative balances. Forest Service was also unable to research and resolve the negative balances prior to completing the financial statements.

CHANGES IN NET POSITION

There was an unexplained decrease of over \$1.6 billion from the ending balance in net position of \$9 billion as of September 30, 1995, and the reported beginning balance of \$7.4 for FY 1997. Since Forest Service did not prepare financial statements for FY 1996, and we did not perform an audit of such statements, we could not rely on the beginning balances in the Statement of Changes in Net Position.

In addition, Forest Service's methodology in determining nonoperating changes did not conform with Office of Management and Budget (OMB) Bulletin No. 94-01 which defines this line-item as the net amount of nonoperating changes during the fiscal year. This methodology was developed by OCFO/NFC personnel after reviewing OMB guidance for Standard General Ledger accounts. Note 23 shows \$26.4 billion in gross adjustments (\$14.3 billion of other increases and \$12.1 billion of other decreases). These adjustments inappropriately consisted of the total balances of various operating, equity, and budgetary accounts. Forest Service officials were unable to develop the appropriate methodology since differences exist in the Standard General Ledger accounts and the general ledger used by Forest Service. This deficiency was reported in our FY 1995 financial statement audit and remains unresolved.

OMB Bulletin No. 94-01 also requires detailed disclosure of material amounts reported in Notes to the Financial Statements. The designation of \$26.2 billion as "other increases and decreases" is not informative and does not fulfill the disclosure requirement.

***Disclaimer
of Opinion***

Due to the significance of the limitations cited above on the scope of our examination, we were unable to express an opinion on the Statement of Financial Position of the Forest Service as of September 30, 1997, and the related Statement of Operations and Changes in Net Position for the period then ended.

ROGER C. VIADERO
Inspector General

July 13, 1998

**REPORT OF THE
OFFICE OF INSPECTOR GENERAL
ON INTERNAL CONTROL STRUCTURE**

***Purpose for
Review of Forest
Service's
Internal Control
Structure***

In planning our audit of the Financial Statements of the Forest Service as of September 30, 1997, we considered Forest Service's internal control structure to determine whether the agency's plan of organization and adopted methods and procedures were sufficient to ensure that (1) reliable financial information was obtained, maintained, and fairly disclosed in Forest Service's reports, (2) resources were sufficiently safeguarded against waste, loss, and misuse, and (3) the use of resources was consistent with laws, regulations, and policies. Our review included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or accounting balances and, for those significant control policies that have been properly designed and placed in operation, performing sufficient tests to provide reasonable assurance that the controls are effective and working as designed.

In making our risk assessment, we considered Forest Service's Federal Managers' Financial Integrity Act (FMFIA) reports as well as our prior and current audit reports on financial matters and internal accounting control policies and procedures. We noted certain matters involving the internal control structure and its operations that we consider reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to ensure that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenue and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports in accordance with applicable accounting standards and to maintain accountability over assets. Our consideration of the internal control structure, made for the limited purposes previously described, would not necessarily disclose all matters in the internal control system that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered material weaknesses.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure does not reduce to a relatively low level the risk that errors or

irregularities, in amounts that would be material to the Financial Statements being audited, would occur and not be detected within a timely period by employees in the normal course of performing their required functions. Matters considered to be material weaknesses are presented in the Findings and Recommendations section of this report.

***Management's
Responsibility
for Internal
Control
Structure***

The management of the Forest Service is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over assets. Projections of any evaluations of the structure to future periods are subject to the risk that procedures may become inadequate because of changes in conditions or the effectiveness of the design and operation of policies and procedures may deteriorate.

***Significant
Internal Control
Structure
Policies and
Procedures***

For the purpose of this report, we have classified Forest Service's significant internal control structure policies and procedures into the following cycles.

1. The Property Cycle includes those transactions related to acquiring real property through lease, purchase, or construction, and the acquisition and maintenance of personal property and equipment.
2. The Revenue Cycle includes those transactions related to timber sales, grazing fees, campground collections, mineral leases, interest income, payments to States and counties based on revenues, other revenues, and maintaining the associated accounts receivable.
3. The Expenditure Cycle includes those transactions related to selecting vendors, purchasing and receiving functions, ensuring quality control, and maintaining accounts payable.
4. The Treasury Cycle includes those transactions related to the operation of the agency general ledger and the summarization of general ledger accounting data into financial and budgetary reports, and the monitoring of agency cash accounts with the U.S. Department of the Treasury.
5. The Financial Reporting Cycle includes those transactions related to the recording (posting)

of journal vouchers in the general ledger; the recognition of events not included in the other cycles that require disclosure; and the preparation of Financial Statements, footnotes, data supplemental to the Financial Statements, and budget and accounting reports.

6. The Overview and Performance Measurement Cycle includes tests of the Overview accompanying the Financial Statements which is a narrative description and background information of the Forest Service and an analysis of its financial and program performance measures.

For each of the internal control cycles listed above, we obtained an understanding of relevant policies and procedures and whether they have been placed in operation and we assessed control risk. We also obtained an understanding of relevant internal control structure policies and procedures designed to determine that data which supports reported performance measures is properly recorded and accounted for to permit preparation of reliable and complete performance information. However, it was not our objective to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Matters that we consider to be reportable conditions are presented in the following findings.

Finding No. 1
Continuing Financial Management Deficiencies
Prevented Forest Service From Preparing
Complete, Reliable, Timely, and Consistent
Financial Statements

The CFO Act of 1990 (Public Law 101-567) was enacted to (a) bring more effective general and financial management practices to the Federal Government through establishment of key positions throughout the Government, (b) provide for the improvement of financial management, accounting systems, and internal controls to ensure reliable financial information, and (c) provide for the production of complete, reliable, timely, and consistent financial information.

**Actions Taken
To Address
Continuing
Internal
Control
Weaknesses**

Since OIG began auditing Forest Service's financial statements in FY 1991, we have identified continuous weaknesses in the agency's accounting for timber revenue; accounts receivables; property, plant, and equipment; as well as for other material Forest Service accounts. In FY 1995, the continuing weaknesses caused pervasive errors in the financial statements, and resulted in an adverse opinion. Because Forest Service could not complete corrective actions in time to improve its financial data for FY 1996, financial statements were not prepared for that year. In June of 1996, the Forest Service along with OIG and OCFO established a financial health task force to address financial accounting deficiencies.

In December 1996, the financial health task force issued a report, Actions for Improving the Financial Health of the Forest Service. This planning document detailed the changes that the task force determined necessary within Forest Service to achieve full financial accountability. In July 1997, the financial health task force issued a financial health desk guide to guide implementation of the group's recommendations in field offices.

During FY 1997, Forest Service units began an intensive review of their accounting data to correct years of incorrect transactions. Field offices began quarterly reviews of obligations to clear invalid or misclassified transactions. In addition, substantial work was performed on reimbursement receivables. Prior year accounts were cleared by billing or charging unrecoverable costs to appropriated funds, current accounts were reviewed to ensure that they were adequately supported, and an automated process that caused erroneous transactions was eliminated.

Improvements were also noted in the area of personal property, where inventories were conducted to ensure that property existed and was properly recorded. In addition, improvements were noted in the amount of invalid posting to suspense and budget clearing accounts.

Forest Service also assessed workforce skills and in September 1997, issued a Financial Management Core Competencies report. This report redefined the financial skills and training needed for Forest Service employees at every level of the organization.

***Sweeping Changes
in Financial
Management Are
Announced by the
Secretary of
Agriculture and
Forest Service
Chief***

Forest Service is implementing sweeping changes in its management structure to improve accountability and reform its financial systems. On April 28, 1998, the Secretary of Agriculture and the Forest Service Chief issued press releases announcing major actions which will be taken to improve and strengthen Forest Service's management and financial accountability. The Secretary pointed out three major steps to address serious accountability and financial management problems noted in prior OIG and GAO audits and reviews.

Put an organization in place with clear accountability for both program and management objectives;

Make sure the Forest Service has the resources it needs to address the substance of the management problems; and

Fill key leadership positions.

The Forest Service Chief announced the establishment of three new management positions: The Chief Operating Officer, Deputy Chief/Chief Financial Officer, and Deputy Chief for Business Operations.² The positions of Chief Operating Officer and Deputy Chief for Business Operations have been filled. According to the Chief's press release, the Deputy Chief/Chief Financial Officer will be filled as quickly as possible. Forest Service also plans to seek temporary increases in its personnel authorizations for budgeting and administrative support positions over the next 3 years as part of the effort to correct critical problems.

***Lack of
Sufficient
Resources Continues***

In our FY 1995, report on Forest Service's financial statements, we reported that staff cuts in the accounting section substantially reduced the number of personnel available to perform accounting

functions. We found that the most experienced and qualified financial statement personnel were transferred to other duties, and that the assigned personnel had other duties, such as preparing payments to States and to counties, which hindered the timely completion of the financial statements.

Improvements were made in the compilation of the FY 1997 financial statements. Forest Service implemented a more efficient process for preparing and reviewing the financial statement line-items and footnotes. Forest Service contracted with an accounting firm with prior Forest Service experience and prior experience assisting other Federal agencies in implementation of the CFO Act to prepare all line-items. Forest Service officials performed various levels of review to ensure that the line-items were prepared correctly by the contractor and that amounts reported appeared reasonable. As a result, we noted improvements over the FY 1995 compilation process evidenced by a substantial reduction in rudimentary errors. However, the lack of sufficient resources contributed to numerous errors and omissions in the initial preparation of line-items for the financial statements.

Forest Service officials did not receive the general ledger trial balance from OCFO/NFC until December 2, 1997, 4 days after the original deadline established by OCFO to complete the financial statements. Additionally, key Forest Service financial statement staff members were also assigned to other critical functions such as preparing payments to States in December and payments to counties in March. Several other staff members had no prior experience in compiling the agency's line items.

Our review of financial statement line-items prepared by Forest Service disclosed the need for accounting adjustments totaling over \$1.9 billion. During our review of the financial statements we presented 10 issue papers to Forest Service reporting various material problems with financial information (see exhibit A). For example, we found errors in the recognition and classification of revenues which resulted in an initial \$234 million understatement of revenues from the sales of goods and services (e.g., timber sale revenues) and a \$217 million initial overstatement of other revenues (e.g., interest and penalty revenues).

Forest Service corrected the errors and omissions and presented the revised Financial Statements to OIG on May 8, 1998.

Even though the use of a private contractor enhanced the compilation process and improved accounting practices used to compile the statements, sufficient Forest Service personnel having expertise in the agency's specific program areas are necessary to ensure that the statements accurately reflect Forest Service's operations. Forest Service was unable to prepare complete, reliable, and timely financial statements because of the (1) lack of sufficient full-time personnel assigned to the compilation process, (2) deficiencies in the current accounting system, (3) late date on which the trial balance was received and the inaccurate data entered into and generated by the CAS, and (4) voluminous adjustments necessary to correct the trial balance.

**Accountability
Can Only Be
Achieved Through
Adherence to
Standardized
Accounting
Policies and
Procedures**

In order for the agency to succeed in its efforts to achieve accountability, Forest Service regions and units must be required to adhere to standardized accounting policies and procedures.

In describing Forest Service's operating environment, a Forest Service commissioned study performed by Coopers & Lybrand, dated March 18, 1998, reported that:

*The operating environment of the Forest Service is highly decentralized, with a culture of independence and local flexibility. Financial processes and practices have followed that trend. However, the Forest Service has reached a point where its financial processes are inefficient and ineffective. * * * Financial processes at the Forest Service need to be applied more consistently, with common definitions for all of its coding structures.*

The report continued that:

There is no consistent structure for financial management practices in the Forest Service. Whether the subject is budget execution, financial plan development, accounting for reimbursable agreements, or creating management codes everyone operates independently. This chaotic financial environment creates

credibility problems. Because everyone "does their own thing" no one has the same answer for the same question.

The report concludes that "only a consolidated leadership function can hope to bring some consistency to the application of basic budgetary and accounting policies and processes." Even though Forest Service's newly implemented organization chart brings the budget and fiscal accounting functions together under the agency's CFO position, it is unclear as to the link between the financial accounting responsibilities in the Washington Office and the responsibilities of Forest Service regional offices and units. This link is critical to ensuring that Forest Service achieves financial accountability. Take for example financial management deficiencies described in GAO's testimony to Congress on March 26, 1998,

The Forest Service has also failed to sustain the management attention needed to implement operational improvements recommended by the agency's own task forces. For instance, a February 1994 report by a Forest Service task force on accountability set forth a seven-step process to strengthen accountability and made recommendations to help the agency change its behavior. The concepts in the task force's report were adopted by the Forest Service's leadership team and distributed agencywide. However, the task force's recommendations were never implemented throughout the agency.

GAO's testimony cited Forest Service's lack of sustained management attention to issues related to escalating costs of its timber program. GAO reported that even though Forest Service has undertaken cost-reduction studies, the agency left the implementation of corrective actions to the discretion of each of Forest Service's nine regional offices, with some regions rapidly pursuing actions towards cost-efficiency while others did not act. GAO also reported that Forest Service was preparing to undertake a third major review of the timber program in the last 4 years while costs of the program remained high.

Forest Service has taken significant steps toward improving its financial accountability. However, much work remains before Forest Service can produce

complete, reliable, timely, and consistent financial statements. Additional steps should be taken by Forest Service to (1) ensure that sufficient resources are available and (2) ensure that field units adopt and adhere to standardized accounting policies and procedures.

***Recommendation
No. 1a***

Ensure that sufficient and qualified full-time staff are assigned to compile and complete the financial statements in a timely manner.

***Recommendation
No. 1b***

Require that regions and units maintain a sufficiently trained staff to adopt and adhere to standardized financial management policies and procedures outlined in the financial health desk guide and USDA's Financial Accounting Standards Manuals, and establish and maintain oversight procedures to ensure responsibilities are being achieved.

Finding No. 2
The Lack of an Integrated Accounting System
and Material Weaknesses Within the Current System
Resulted in Inaccurate and Unreliable
Financial Data

General control deficiencies exist within the budgetary and proprietary accounts in the CAS. In addition, Forest Service maintains stand-alone accounting systems that produce accounting data but does not interface with the CAS. Analyses are then performed to determine the kinds of information not included in the ledger and any necessary adjustments that are required. However, material weaknesses exist because (a) general controls are not adequate within the CAS, (b) all accounting functions are not integrated within the ledger, and (c) some ledger accounts are not used to prepare the Financial Statements and are not reconciled by Forest Service personnel to amounts presented in the Financial Statements.

Since FY 1993, the Forest Service has used its general ledger accounts as the primary source to begin compilation of agency Financial Statements. Use of the general ledger allows Forest Service to begin with a trial balance. This trial balance is generated from the general ledger subsystem of the CAS. The OCFO/NFC developed and maintains the CAS.

General Controls
Weaknesses at
OCFO/NFC

In our FY 1997 audit of general controls at the OCFO/NFC (Audit Report No. 11401-3-FM), we issued an adverse opinion on the general control environment for the following reasons.

- Critical OMB Circular No. A-130 certifications and recertifications have not been performed on systems which process billions of dollars in payments. Certifications and recertifications provide assurances that systems have adequate security to prevent misuse or unauthorized access to or modification of information. It also provides assurances that the systems operate effectively and provide appropriate confidentiality, integrity, and availability through the use of cost-effective management, personnel, operational, and technical controls.
- Access and security controls over OCFO/NFC systems are poor.

- Systems lack appropriate documentation, resulting in inefficient operations and numerous operational problems.
- Reconciliation procedures at OCFO/NFC are ineffective causing extensive vulnerabilities to exist in the payments made by the OCFO/NFC on behalf of its clients.
- Adjustments to OCFO/NFC data bases are not sufficiently controlled and raise substantial concerns about the data integrity of the OCFO/NFC accounting and payment systems.

As a result of these general control deficiencies, Forest Service's accounting data was materially impacted and Forest Service's ability to analyze and reconcile accounting data is materially reduced. However, Forest Service has the ultimate responsibility for producing and reporting reliable data.

***Inaccurate and
Unreliable
Stand-alone
Automated
Systems***

Several major accounting functions are not integrated into the General Ledger and, therefore, require manual intervention to ensure that transactions are included in the Financial Statements. Because reconciliations of this manually entered information are not always completed by the Forest Service, errors in timber sales revenue, reimbursements, accounts receivable, and property may not be identified and corrected.

Timber Revenue - Timber sales were accounted for in the ATSA system, a separate stand-alone system maintained by the Forest Service outside the general ledger. Payments for timber were received through the Bank of America Lockbox System. These collections were posted to the ledger in the Timber Sale Deposit Fund. As timber was cut, revenue was accrued in ATSA. Individual Forest Service units were required to transmit adjustments to the ledger to recognize timber revenues and transfer those revenues from the deposit fund to other fund accounts where they could be used in program activities. Due to timing differences and because yearend accruals were manually recorded, adjustments were needed to reverse prior year revenues and accrue revenues at yearend. Although a monthly reconciliation of timber revenue was performed at the unit level, a yearend reconciliation between revenue in the ATSA system and revenue posted to the general ledger has not been performed. This weakness was reported in our FY's 1993, 1994 and 1995 audits of Forest Service's

Financial Statements but has not been corrected. Forest Service officials established a nationwide reconciliation process during FY 1997, but did not complete the reconciliation for the current year.

Property, Plant, and Equipment - Balances in the general ledger do not properly reflect the value of all Forest Service real property. Forest Service considers its Annual Report of Real Property Owned or Leased (GSA-1166) to be the most reliable source of real property values. The 1166 report is compiled from manually kept property records for fixed assets including land, buildings, roads, and other structures. A yearend adjustment is necessary to match general ledger property values to the 1166 report. Forest Service, to date, has not been able to reconcile 1166 asset values to its general ledger.

Our audit tests in prior years confirmed that the 1166 report did not reconcile to the subsidiary manual real property summary ledgers, and the summary ledgers did not reconcile to individual ledger sheets for each property item. In addition, supporting documentation did not exist for the majority of property tested.

In FY 1997, Forest Service planned to use data from its new automated INFRA system to account for and report on its real property. However, many Forest Service units had input only capitalized values at \$100,000 or more into the automated system anticipating in that the capitalization threshold would be raised from \$5,000 to \$100,000. Although Forest Service formally adopted the change in capitalization level on November 13, 1997, officials rescinded their decision after a February 1998 meeting with representatives from the GAO, OIG, and the OCFO. Forest Service then used the FY 1996 GSA-1166 report, and added capitalized amounts recorded in the CAS for FY 1997 to determine real property amounts. These amounts did not agree with the general ledger and could not be reconciled.

Reimbursements - Currently, Forest Service has two different revenue accounts in its general ledger for reimbursement revenue (e.g., reimbursement from States for firefighting assistance). Earned Appropriation Reimbursements, Account 5205, contains the automated compilation for all reimbursement revenue recorded in the ledger during the year. In addition, Financing Source from Reimbursements, Account 5810, was added to the ledger by a manual adjustment after OCFO/NFC employees obtained a

computer file of reimbursable expenditures. Forest Service determined the \$131 million of Reimbursements presented in its Statement of Operations using the general ledger account of Earned Appropriation Reimbursements. However, the Financing Source from Reimbursements account was not used in the financial statements and totaled \$15 million less than the other reimbursement account. The composition of the unreconciled \$15 million difference is unknown, and represents an out-of-balance condition between the general ledger accounts and Financial Statements. This condition causes misstatements of Forest Service's Cumulative Results of Operations (Equity), and prevents Forest Service from properly reconciling and presenting changes in Net Position from year to year.

Accounts Receivable - Forest Service did not have an integrated accounts receivable system as part of its general ledger. Each month, Forest Service field offices must transmit accounts receivable to the OCFO/NFC. The accounts receivable are then reversed (removed) during the following month. This is done each month because OCFO/NFC's accounting feeder system used by Forest Service cannot match individual cash collections or individual writeoffs with specific receivables. Additionally, writeoffs are not posted to the ledger. Any amounts written off during the month are simply excluded from the accounts receivable postings during the subsequent month. Since writeoffs are not posted to the ledger, the provision for loss expense account is understated.

On October 17, 1997, Forest Service transmitted to OCFO/NFC a significant number of adjustments to accounts receivable. The adjustments reflected total aggregate corrections (debits and credits) of \$166.3 million. A Forest Service official stated that Forest Service units were allowed to make the adjustments to correct erroneous yearend balances.

Accounts Payable - The lack of an integrated subsidiary ledger system hampered the accurate reporting of accounts payable. Forest Service's use of a cumbersome monthly input process led to the recording of erroneous transactions in the general ledger. To compensate for these errors, Forest Service tested a statistical sample of obligation transactions, and, based on the results of the sample, made adjustments totaling \$25.5 million to increase accounts payable and current expenses, and an adjustment of \$33.3 million to decrease

undelivered orders, a component of unexpended appropriations which is reflected in the equity section of the Statement of Financial Position.

**Implementation
of FFIS**

In January 1995, the Department announced the procurement of an off-the-shelf financial system to replace the existing CAS used by Forest Service and other agencies. Pilot testing of the new Foundation Financial Information System (FFIS) was performed during FY 1997. This system will integrate subsidiary ledgers with the general ledger and contain accounts receivable and payable subsidiary ledgers to support general ledger amounts. FFIS was scheduled to be fully operational agencywide by October 1, 1998. However, numerous problems have plagued the implementation of this system. Forest Service management now projects full implementation of the system on October 1, 1999.

**Recommendation
No. 2a**

Complete the timber revenue reconciliation process at each yearend.

**Recommendation
No. 2b**

Ensure timely implementation of INFRA.

**Recommendation
No. 2c**

Determine if two different reimbursement revenue accounts are needed in the general ledger, and, if needed, reconcile the two accounts to determine why they differ and if adjusting entries are needed.

Finding No. 3
Internal Controls Were Not Sufficient to
Safeguard Assets of to Ensure that Field Level
Financial Records Were Accurate

Forest Service's Statement of Financial Position, as of September 30, 1997, reported total assets of approximately \$11.8 billion. The total Fund Balances with U.S. Treasury and the Property, Plant, and Equipment accounts comprise a combined total of \$11.6 billion or 98.3 percent of the total assets. We found that internal controls over the accounts were not sufficient to ensure that the assets were adequately safeguarded.

We also concluded that Forest Service's complex system of management codes increased the risk of misuse of budgetary resources and that, due to inadequate internal controls, errors in field level data input contributed to unreliable financial data.

The Statements on Auditing Standards (SAS) No. 1 states that the broad objectives of internal accounting controls are to provide management with reasonable assurance that assets are safeguarded from unauthorized use or disposition and that financial records are reliable to permit the preparation of financial statements. SAS No. 1 also states that:

In the context of internal accounting controls, safeguarding of assets refers only to protection against loss arising from errors and irregularities in processing transactions and handling the related assets. It does not include the loss of assets arising from management's operating business decisions.

**Fund Balances
With Treasury
Are Not
Sufficiently
Safeguarded**

Forest Service's Statement of Financial Position, as of September 30, 1997, reported total Fund Balances with the U.S. Treasury and Cash of approximately \$2.9 billion or 24.6 percent of the total assets. Fund Balances with the U.S. Treasury represents (a) amounts that are available from which Forest Service is authorized to make expenditures and pay liabilities (entity assets) and (b) amounts held on behalf of other entities (nonentity assets).

We found that automated and manual reconciliations of Fund Balances with Treasury were not sufficient to

ensure that cash accounts were safeguarded against errors or irregularities in processing transactions. The account Fund balances with Treasury could not be verified because of variances between amounts shown in Treasury records and the amounts reflected in the CAS utilized by Forest Service. For FY 1997, the OCFO/NFC manually adjusted USDA's agencywide fund accounts by a net of over \$1 billion to agree with Treasury records without fully researching and reconciling the differences.³ We could not readily determine the amount of adjustments directly related to Forest Service.

In addition, yearend adjusting entries totaling \$92.6 million were made to Forest Service Fund Balance with Treasury accounts to adjust the beginning ledger balances with Treasury records. Differences were not fully researched or reconciled.

Without sufficient reconciliations, there was a high level of risk that errors or irregularities could have occurred and gone undetected.

***Complex System
of Management
Codes Increases
Risk of Misuse of
Budgetary
Resources***

The risk of errors or irregularities and the potential unauthorized use of appropriations or trust funds are further increased by Forest Service's use of its vast and complex management code system.

At the field level, Forest Service personnel input various accounting transactions into feeder systems using management codes. The feeder systems relay transaction data into the CAS.

CAS processes the data into the BUDG system for budgetary accounting purposes and into the LEDG system for financial accounting. Although the same data is processed into LEDG and BUDG, the two systems do not produce balanced results.

- Information processed into the BUDG system is grouped and identified by appropriation, fund code, Forest Service region, unit (i.e., national forest), subunit (i.e., ranger district), and management code.
- The same information is processed into the LEDG system, and is grouped by general ledger account number, treasury symbol, and Forest Service region. Once information is processed into LEDG, it is no longer identified by management code. Since management codes are used by field units to input individual transactions, the loss of these codes in LEDG makes it virtually impossible to

retrace individual transactions back to source documentation.

We were unable to determine what factors caused the two systems to be out of balance. OCFO/NFC has tried to resolve this problem, but has not been able to determine the source of the problem. Currently, OCFO/NFC uses an automated adjustment to the LEDG system to bring obligations into balance with BUDG because Forest Service field personnel review BUDG data and have determined it to be more accurate.

The Forest Service utilized about 105,000 management codes which contained 271,000 lines of accounting. When transactions are initially posted, only the first line of accounting is input into the accounting system. The transactions are then distributed over the detailed lines of accounting through what Forest Service calls the "explosion" process. This process allocates costs throughout funding sources available to Forest Service.

Forest Service employees have the ability to add or change management codes, and thus the allocation of costs, at any time during the year, which significantly increases the risk that waste and misuse of budgetary resources can occur. For example, we found that 46 percent of active FY 1997 accounting lines in management codes had been added or changed in the last 3 months of the fiscal year. Only 8 percent of these accounting lines had remained unchanged since the start of the fiscal year in October 1996. Forest Service commissioned a study by Coopers & Lybrand which reported:

The capability to work around "charged as worked" initiatives is the most serious criticism of the current accounting and budget infrastructure. This capability is often cited as the primary reason for the Forest Service's lack of financial credibility.

The Coopers & Lybrand study recommended that Forest Service:

Modify the current [management code] structure in order to reduce the instances of "charged as worked" non-compliance.

**Controls for
Safeguarding
Property, Plant
and Equipment
Were Not Fully
Implemented**

As of September 30, 1997, Forest Service reported property, plant, and equipment totaling almost \$8.7 billion or 73.7 percent of the agency's total reported assets.

Controls for safeguarding property, plant, and equipment were not fully prescribed or implemented. Our prior financial statement audits disclosed pervasive errors in accounting for property, plant, and equipment. We found that the manually kept records for land, buildings, and roads were not (a) subject to uniform accounting controls, (b) consistently updated, and (c) supported by adequate cost documentation. In July 1996, to address these and other deficiencies reported in our FY 1995 financial statement audit, a financial health task force was formed with representatives from the Forest Service, OIG, and OCFO. From July to November of 1996, the representatives held meetings to develop a corrective action plan for the deficiencies. Individual task force teams were formed to address the main aspects of financial management including Forest Service's accounting for property, plant, and equipment.

In the footnotes to the financial statements for FY 1997, Forest Service reported that it does not have reliable account balances for its real property (land, buildings, and roads) which comprises 94.3 percent of the reported \$8.69 billion of property, plant, and equipment. Physical inventories and valuations of these assets have not been completed for real property. Forest Service's plans are to complete the real property inventories and valuations by July 31, 1998.

On November 13, 1997, the Forest Service informed the Acting CFO that it adopted the Department's \$100,000 capitalization threshold to be used in reporting the value of real property. However, neither Forest Service nor OCFO had obtained sufficient evidence to justify the change in the capitalization threshold or show that the proposed increase in capitalization level would not materially effect the financial statements. On December 8, 1997, we provided an issue paper to Forest Service and OCFO to express the following concern about the change.

To measure the true cost of major Forest Service programs such as the timber sale program, revenue should be properly matched with the expenses for the year. In order to properly match revenue with expenses, all material real property

acquisitions as well as improvements or costs incurred to extend the life of an asset should be capitalized and depreciated over the asset's useful life. Thus, the depreciation expense can be charged against the revenue for the respective year and present a realistic picture of the net results (loss or gain) of major program operations such as timber sale activity. With the public's and Congress' increased interest in the costs of logging in the national forests, Forest Service should ensure that the costs are accurately measured.

On February 6, 1998, representatives from GAO, the Forest Service, the OCFO, and OIG met to discuss property issues. At that meeting, Forest Service officials decided that they would rescind the new \$100,000 capitalization level and would attempt to report real property account balances using the \$5,000 capitalization threshold originally in effect.

***Errors in Field
Level Data Input
Contributed To
Unreliable
Financial Data***

Continuing errors in inputting data at the field level resulted in inaccurate and unreliable financial data.

Forest Service made progress in efforts to clean up erroneous data. For example, substantial efforts were devoted during FY 1997 by field personnel to clean up data in feeder systems and the CAS. Field units made quarterly reviews of obligations recorded in OCFO/NFC feeder systems to clear out erroneous transactions. Substantial work was also performed in cleaning up prior year reimbursement accounts by billing and charging unrecoverable costs to appropriated funds, and ensuring that current reimbursement accounts were adequately supported. Substantial efforts were also directed in the personal property accounts by taking inventories of personal property and ensuring that values in the feeder system were appropriate.

However, we continued to find problems with data input at the field level. For example, during our accounts receivable confirmation testing, we identified 10 transactions totaling \$25,930,397 included in accounts receivable which were not valid receivables. Forest Service field units erroneously posted items on its monthly accounts receivable listings such as potential claims for fire trespass, advances, and cash collections. In response to our Issue Paper No. FS 97-03, dated March 16, 1998, Forest Service made adjusting entries to eliminate these errors.

In addition, obligation transactions continue to be misclassified in the accounting system. Although improvements were made clearing out invalid obligations during FY 1997 and in the classification errors of obligations between undelivered orders and accounts payable, material adjustments are still required at yearend to correct account balances.

Data input errors continue to be a concern, and it is doubtful that Forest Service field units will eliminate errors without better supervisory oversight of data input into the accounting systems. Although conversion to the new FFIS accounting system may help eliminate some data input errors through the use of better controls over data input, sufficient supervisory reviews over data input will be needed to achieve fiscal integrity.

***Recommendation
No. 3a***

Work with OCFO/NFC to reconcile funds balances per the general ledger with Treasury records, fully documenting the nature of differences and make any needed corrections.

***Recommendation
No. 3b***

Implement recommendations in the Coopers & Lybrand study to modify the current management code structure to reduce the risk of noncompliance with "charged as worked" initiatives.

***Recommendation
No. 3c***

Implement measures to improve supervisory oversight of data input and data cleanup efforts to ensure reliable data is in the accounting system.

***Recommendation
No. 3d***

Ensure that property inventories are completed and values are properly supported and capitalized in accordance with the authorized capitalization threshold.

ROGER C. VIADERO
Inspector General

July 13, 1998

EXHIBIT A
SUMMARY OF AUDIT ISSUE PAPERS AND
AUDIT ADJUSTMENTS MADE BY FOREST SERVICE

ISSUE PAPER NO.	DATED	ISSUE	AMOUNT OF ADJUSTMENT (Millions)
Unnumbered	12/8/97	Establishment of a Capitalization Threshold of \$100,000 for Real Property	N/A
FS 97-02	2/10/98	Classification of Unmatured Timber Sale Contracts as an Asset	\$1,219.5
FS 97-03	3/16/98	Classification and Accuracy of Accounts Receivable	\$ 26.5 ¹
FS 97-04	4/1/98	Overstatement of Non-Federal Interest Revenue and Provision for Losses	\$ 47.1
FS 97-05	4/2/98	Overstatement of Provision for Losses	\$ 61.2
FS 97-06	4/2/98	Understatement of Depreciation and Amortization Expenses and Invested Capital	\$ 26.2
FS 97-07	4/10/98	Unreliable Balance in the Provision for Losses	N/A
FS 97-08	4/21/98	Accounting for Other Post Employment Benefits	\$ 32.9
FS 97-09	4/30/98	Understatement of Expenses for Claims paid by the Treasury Judgment Fund	\$ 140.0
FS 97-10	4/30/98	Errors in the recognition and classification of revenues	\$ 361.4
TOTAL ADJUSTMENTS			\$1,914.8

¹ This amount includes reductions to accounts receivable of \$25.9 million and related reductions to interest receivable of \$546,520.

EXHIBIT A
SUMMARY OF AUDIT ISSUE PAPERS AND
AUDIT ADJUSTMENTS MADE BY FOREST SERVICE

Unnumbered Issue Paper, December 8, 1997 - We concluded that, in adopting a \$100,000 capitalization threshold for reporting real property, Forest Service had not obtained sufficient evidence to justify the change or show that the increase would not materially effect the financial statements.

Issue Paper No. 97-02, dated February 10, 1998 - We concluded that reporting the total value of unmatured timber sale contracts (\$1.2 billion) would significantly overstate Forest Service assets. Federal Accounting Standards Advisory Board (FASAB) had not established standards for valuing timber as a natural resource, and including the amount of contracts for timber (which is to be sold at fair market value) would not accurately reflect the total value of all timber. We recommended that Forest Service not include this amount in its financial statements.

Issue Paper No. 97-03, dated March 16, 1998 - During our confirmation testing of accounts receivable, we identified overstatements of \$25.9 million. We found that Forest Service field units had improperly included fire trespass claims for which the Forest Service neither had a repayment agreement from the individual, nor a court order for restitution. We also found that advances paid by timber purchasers were improperly included as receivables. We recommended that Forest Service make adjustments to remove the overstatements from accounts receivable.

Issue Paper No. 97-04, dated April 1, 1998 - We concluded that the recognition of \$47.1 million determined to be uncollectible would materially overstate interest receivable and the provision for losses (an expense account). We recommended that Forest Service reduce interest revenue and provision for losses by \$47.1 million.

Issue Paper No. 97-05, dated April 2, 1998 - We concluded that at least \$61.2 million recorded in the current year's provision for losses is related to correcting the omission reported in our FY 1995 financial statement audit. Therefore, Forest Service should have considered this as a correction of an error, and recorded that amount as a prior period adjustment. We recommended that Forest Service reduce the provision for losses account and a prior period equity account by \$61.2 million.

Issue Paper No. 97-06, dated April 2, 1998 - We found that an incorrect adjusting journal entry resulted in a \$26.2 million understatement of depreciation expense, and a related understatement in the invested capital equity account. We recommended that Forest Service increase the depreciation expense account and the invested capital account by \$26.2 million.

EXHIBIT A
SUMMARY OF AUDIT ISSUE PAPERS AND
AUDIT ADJUSTMENTS MADE BY FOREST SERVICE

Issue Paper No. 97-07, dated April 10, 1998 - We found that deficiencies in Forest Service postings of accounts receivables resulted in a negative expense being reported in the financial statements for the line-item "Provision for Losses." We discovered that writeoffs were not posted and contributed to the negative balance in this account. We were unable to determine the amount of writeoffs which should have been included, and did not recommend an adjustment. However, we recommended that Forest Service include a footnote to the financial statements explaining that writeoffs were not included and the negative impact on the "Provision for Losses."

Issue Paper No. 97-08, dated April 21, 1998 - We found that Forest Service did not include an estimated \$32.9 million in accrued liabilities for buyouts offered to Forest Service employees. We recommended that Forest Service increase its liabilities by the \$32.9 million.

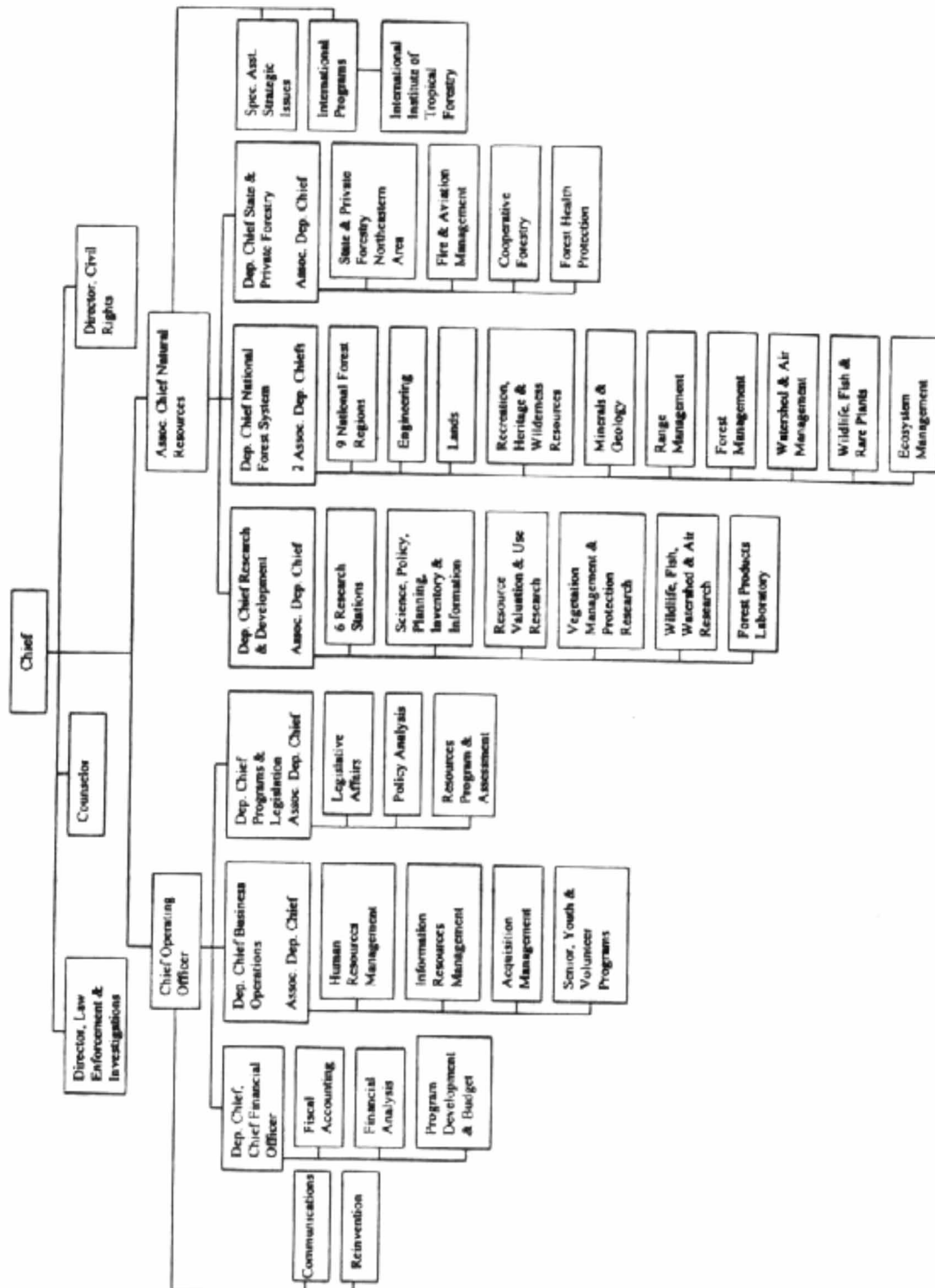
Issue Paper No. 97-09, April 30, 1998 - We found that Forest Service had not recorded an expense of \$140 million for a settlement agreement made with a timber company during FY 1997. The Treasury Judgment Fund was used to pay \$135 million in FY 1997, and was to pay another \$5 million in a future year. FASAB standards require that the entire \$140 million be included as a liability, and then expensed by Forest Service when it was determined that payments would be made from the judgement fund. We recommended that Forest Service show this expense along with an imputed financing source.

Issue Paper No. 97-10, April 30, 1998 - We found that, due to erroneous adjusting journal entries, (1) revenues from the sales of goods and services was understated by \$144 million, (2) other revenues were overstated by \$127 million, (3) and another \$90 million of revenue from the sale of goods and services was misclassified as other revenue. We recommended that Forest Service make adjusting entries to correct the revenue accounts.

Forest Service made the appropriate adjustments for all of the above issue papers.

**EXHIBIT B
FOREST SERVICE'S
NEW ORGANIZATIONAL CHART**

USDA Forest Service Organization Chart (4/30/98)



**REPORT OF THE
OFFICE OF INSPECTOR GENERAL
ON COMPLIANCE WITH LAWS AND REGULATIONS**

***Purpose and
Scope of
Our Review***

The management of Forest Service is responsible for compliance with laws and regulations applicable to the Forest Service. As part of obtaining reasonable assurance about whether the FY 1997 Financial Statements are free of material misstatement, we tested compliance with laws and regulations that may directly affect the Financial Statements and certain other laws and regulations designated by OMB. We tested compliance with:

Budget and Accounting Procedures Act of 1950, chapter 946, 64 Stat. 832 (codified as amended in scattered sections of 31 U.S.C.)

Anti-Deficiency Act, chapter 510 3, 34 Stat. 49 (codified as amended in 31 U.S.C. 1341, 1342, 1349-1351, 1511-1519 (1988))

FMFIA Act of 1982, Public Law 97-255, 96 Stat. 814, 31 U.S.C. 1105, 1113, 3512 (1988)

Single Audit Act of 1984, Public Law 98-502, 98 Stat. 23327, 31 U.S.C. 7501-7507 (1988)

Fair Labor Standards Act of 1938, chapter 676, 52 Stat. 1060 (codified as amended in 5 U.S.C. 1308, 3323, 8331-8348 (1988))

Prompt Payment Act, Public Law 97-177, 96 Stat. 85, 31 U.S.C. 3901-3906 (1988)

Debt Collection Act of 1982, Public Law 97-365, 96 Stat. 1749 (codified in scattered sections of 5 U.S.C., 18 U.S.C., 26 U.S.C., 28 U.S.C., 31 U.S.C.)

CFO Act of 1990, Public Law 101-576, 104 Stat. 2838 (codified in scattered sections of 5 U.S.C., 31 U.S.C., 38 U.S.C., 42 U.S.C.)

Government Management Reform Act of 1994 (Public Law 103-356, 108 Stat. 3415)

National Defense Authorization Act of 1991, Public Law 101-510, title XIV, §1405, 104 Stat. 1675, 1676, 1677, 1678, 1679, §§1551-1557

The Economy Act (codified in sections of 31 U.S.C.)

FFMIA of 1996

As part of our audit, we also obtained an understanding of the process by which the Forest Service identifies and evaluates weaknesses required to be reported under the FFMIA. We also reviewed Forest Service policies, procedures, and systems for documenting and supporting financial, statistical, and other information and assessed whether the information and manner of its presentation in the Overview of the Reporting Entity section is materially consistent with the information in the Financial Statements as of September 30, 1997. Although we determined that the information in the Overview section was consistent with information in the Financial Statements, we were unable to test supporting documentation for program performance measures because data compiled by Forest Service field units was not completed timely to conduct audit testing. Therefore, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Financial Statements or the sensitivity of the matter would cause it to be perceived as significant by others. Two material instances of noncompliance noted during our audit are presented in the Findings and Recommendations section of this report.

***Finding No. 4
Financial Management Systems
Were Not in Compliance With the
Federal Financial Management
Improvement Act***

Forest Service's financial management systems do not comply with the requirements of the FFMIA of 1996. The FFMIA requires each agency to implement and maintain financial management systems that comply substantially with Federal Financial Management System Requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level.

Forest Service uses the services of the OCFO/NFC's CAS for its accounting processing and general ledger. Since the Forest Service, along with other agencies, depends on information supplied from OCFO/NFC to prepare its financial statements, review results of FFMIA compliance at the OCFO/NFC were primarily used in our analyses. These results are presented in detail in OIG's Audit Report No. 50401-24-FM, Audit of USDA's Fiscal Year 1997 Financial Statements.

Forest Service's financial management system is not fully integrated with its subsystems and does not adhere to the requirements of the U.S. Government Standard General Ledger. The system does not have

- standard data classifications established and used for recording financial events,
- common processes used for processing similar kinds of transactions (e.g., two different ledger accounts were used to compute amounts for financing sources from reimbursements),
- adequate internal controls over data entry, transaction processing, and reporting, and
- single source data entry (e.g., purchaser road credits, obtained from ATSA, are manually input into property ledgers).

As shown in our Opinion and Internal Control sections of this report, the financial management system cannot record, process, summarize, and report financial information timely and accurately. Various recommendations are made to address weaknesses. Conversion to the new FFIS accounting system should

resolve noncompliance with the Standard General Ledger and improve other controls.

In addition, Forest Service was significantly behind schedule in addressing the Year 2000 (Y2K) conversion project. This delay will hamper the ability of the Forest Service to meet required timeframes for resolving Y2K issues.⁴ Forest Service had identified 94 software applications which are mission critical and require renovation for Y2K. As of November 1997, Forest Service was over 4 months behind schedule in assessing its systems and programs.

**Recommendation
No. 4**

Work with the OCFO/NFC to ensure that financial management systems comply with the FFMIA.

***Finding No. 5
Deficiencies in the Exchange of
Federal Lands Could Result in
Material Losses to the Government***

In our audit of the Land Adjustment Program for the Humboldt-Toiyabe National Forest (Audit No. 08003-02-SF), we identified serious deficiencies in the exchange of Federal lands which could result in material losses to the Government.

In one land exchange, Forest Service personnel disregarded Forest Service's Washington Office's guidelines and advice from the Office of the General Counsel (OGC) during bargaining sessions with private parties. The OGC reviewed the Federal Land Exchange Facilitation Act (FLEFA) of 1998, and in an opinion dated March 13, 1996, concluded that legal requirements for land exchanges include

- land exchanged must be of equal value,
- land values must be determined using Federal Appraisal Standards, and
- bargaining may only be used to objectively reconcile difference in appraisals which meet Federal Appraisal Standards.

We found that Forest Service officials excluded the participation of Federal appraisers and accepted uncorroborated valuations by an appraiser recommended by the private party. The uncorroborated valuations may have resulted in a loss to the Government of about \$6 million. In response to an OIG request for an opinion, the OGC concluded that Forest Service's bargaining process for this exchange failed to comply with the legal requirements of FLEFA.

In another exchange, we found that Forest Service officials entered into an improper agreement that gave a private party control of 850 acres of forest lands valued at \$6.5 million, but did not require the private party to identify any private lands that would be offered in exchange. On April 17, 1997, we recommended that Forest Service withdraw this agreement. As a result, a certified letter was sent by the forest supervisor to the third-party facilitator, advising that the Forest Service was withdrawing from the land exchange proposal.

Additionally, we questioned the Forest Service's acceptance of three land appraisals based on speculative assumptions which were not in conformance with Uniform Appraisal Standards for Federal Land Acquisitions required for Federal land exchanges. We determined that the use of these speculative assumptions in the three appraisals overvalued the land to be acquired by \$8.9 million.⁵

Continuing deficiencies in the exchange of Forest Service lands could result in material losses. Because recommendations to address these and other deficiencies in the land exchange program will be included in Audit Report No. 08003-02-SF, no additional recommendations are made.

ROGER C. VIADERO
Inspector General

July 13, 1998

ABBREVIATIONS

ATSA	Automated Timber Sale Accounting
CAS	Central Accounting System
CFO	Chief Financial Officer
FFIS	Foundation Financial Information System
FFMIA	Federal Financial Management Improvement Act
FLEFA	Federal Land Exchange Facilitation Act
FY	Fiscal Year
GAO	General Accounting Office
INFRA	Infrastructure
OCFO/NFC	Office of the Chief Financial Officer/National Finance Center
OGC	Office of the General Counsel
OIG	Office of Inspector General
OMB	Office of Management and Budget
USDA	U.S. Department of Agriculture

1. An integrated general ledger requires that all financial transactions be posted, either individually or in summary, to the general ledger, regardless of the origin of the transaction.
2. See exhibit B 1 for the new Forest Service organizational chart.
3. OIG Audit Report No. 11401-3-FM: Fiscal Year 1997 National Finance Center, Review of Internal Control Structure, dated March 28. The adjustment of \$1 billion was the total for USDA, and the amount related to Forest Service could not be readily determined.
4. Review of Year 2000 Conversion Project, U.S. Department of Agriculture, Office of Inspector General, Audit Report No. 50601-1-FM, March 1998.
5. The \$8.9 million includes the \$6 million in the first land exchange discussed above.

FOREST SERVICE

An Overview of Fiscal Year 1997 Operations and Results

I. INTRODUCTION

Forest Service financial statements have been completed for fiscal year 1997 under the Chief Financial Officers Act of 1990. Following is a discussion of these statements and the financial results for Fiscal Year (FY) 1997 and selected highlights of Forest Service programs and management accomplishments. Details of Forest Service programs and management accomplishments may be found in the "Report of the Forest Service, Fiscal Year 1997."

The Mission of the Service

The Forest Service mission is to sustain the health, productivity and diversity of our Nation's forest, rangeland and aquatic ecosystems to meet the needs of present and future generations. The phrase "Caring for the Land and Serving People" expresses the spirit of this mission. Implicit in this statement is the collaboration with partners as stewards of the Nation's forests and rangeland.

As a lead Federal Agency in natural resources conservation, the Forest Service provides leadership in the protection, management, and use of the Nation's forest, rangeland and aquatic ecosystems. An ecosystem approach to management integrates ecological, economic and social factors to maintain and enhance the quality of the environment to meet current and future needs. The Forest Service ensures sustainable ecosystems and provide recreation, water, timber, minerals, fish, wildlife, wilderness and aesthetic values for current and future generations on National Forest System land.

Organizational Structure

The top administrative official of the Forest Service is the Chief, who, through the Under Secretary for Natural Resources and the Environment (USNRE), reports to the Secretary of Agriculture. The Chief oversees the following five Deputy areas:

The National Forest System (NFS) provides for the protection, management and utilization of approximately 192 million acres of national forests and grassland located in 44 states, Puerto Rico, and the Virgin Islands for a wide variety of purposes and values. Programs run the spectrum from preservation of our wilderness areas to intensive resource utilization for timber harvest or developed recreation areas.

Forest and Rangeland Research covers four broad areas: Vegetation Management and

Protection Research; Wildlife, Fish, Watershed and Atmospheric Sciences Research; Resource Valuation and Use Research; and Forest Resources Inventory and Monitoring. Each day, field foresters, land managers, farmers, ranchers, urban foresters, public interest groups and many others apply the know-how developed by Forest Service scientists and cooperators in academia and industry. Long-term scientific research provides many tools used to furnish early warnings and solutions for potential problems.

The goal of State and Private Forestry is to maintain and improve, through collaborative stewardship, the health and productivity of the Nation's urban and rural forests and related economies. The State and Private programs provide technical and cost-sharing assistance to help assure sound stewardship and use of the vast state and private forest land, utilizing non-regulatory approaches. State and Private Forestry helps State, local and tribal governments and small non-industrial private forest landowners manage forest resources to meet economic, social and environmental goals. State and Private Forestry funds are leveraged through cost-shares to provide increased on-the-ground project funding.

Two additional Deputy areas (Operations and Programs and Legislation) provide support services essential to accomplishing the Forest Service mission. The primary contribution of these Deputy areas is to ensure organizational effectiveness by creating and maintaining an atmosphere where people are respected, trusted, and valued and where expertise and professionalism are rewarded for achieving negotiated objectives.

Although not a Deputy area, the International Forestry staff helps promote sustainable forest management throughout the world by providing international assistance and scientific exchange activities. Additionally, Law Enforcement and Investigations reports directly to the Chief through its Director, as does the Public Affairs Office.

GPRA Strategic Plan

To comply with the Government Performance and Results Act (GPRA), the Agency has prepared a Strategic Plan to establish strategic goals and objectives that will be used to implement the mission, promote accountability, and focus on agency priorities over the next five years. The goals in the Strategic Plan provide the basis for developing the program objectives and performance measures for the FY 1997 GPRA Performance Plan. The annual Performance Plans constitute the basic management tool to direct resources and implement key strategies and identify specific efforts that will be used to achieve the goals and objectives.

Both the Strategic and the Annual Performance Plans were tiered from the process outlined in the Forest and Rangeland Renewable Resources Planning act of 1974 (RPA). The 1995 Draft RPA Program established the structure and content for the agency's GPRA planning. The following goals form the basis for these plans:

- 1) Ensure Sustainable Ecosystems.
- 2) Provide Multiple Benefits for People within the Capability of Ecosystems.
- 3) Ensure Organizational Effectiveness.

Figure 1
Fiscal Year 1997 Selected Measures of Performance funded by Forest Service Appropriations, Knutson-Vandenberg Act (K-V) and Brush Disposal (BD) deposits ^{1, 2}

	Appropriated	K-V	BD	TOTAL
Acres of Wildlife Habitat Restored or Enhanced	206,067.2	156,997.5	0.0	363,064.7
Miles of Inland Fish Streams Restored or Enhanced	950.0	247.8	0.0	1,197.8
Acres of Inland Fish Lakes Restored or Enhanced	6,631.4	394.0	0.0	7,025.4
Miles of Anadromous Fish Streams Restored / Enhanced	900.3	89.8	0.0	990.1
Acres of Anadromous Fish Lakes Restored or Enhanced	3,713.0	5.0	0.0	3,718.0
Acres of TE&S Terrestrial Habitat Restored or Enhanced	122,280.7	38,448.0	0.0	160,728.7
Miles of TE&S Aquatic Stream Habitat Restored or Enhanced	161.2	5.1	0.0	166.3
Acres of TE&S Aquatic Lake Habitat Restored or Enhanced	118.3	0.0	0.0	118.3
Acres of Soil & Water Resource Improvements	46,091.7	17,470.9	0.0	63,562.6
Acres of Reforestation	128,052.0	193,446.0	0.0	321,498.0
Acres of Timber Stand Improvement	118,926.0	138,955.0	0.0	257,881.0
Acres of Noxious Weed Treatments	72,357.6	30,191.8	0.0	102,549.4
Acres of Range Non-Structural Improvements	36,856.0	12,534.0	0.0	49,390.0
Number of Grazing Allotments Administered to Standards	4,735.0	0.0	0.0	4,735.0
Number of Grazing Allotments Analyzed/Decisions Implemented	621.0	0.0	0.0	621.0
Energy Operation Processed	455.0	0.0	0.0	455.0
Bonded Non-energy plans Operations Processed	961.0	0.0	0.0	961.0
Timber volume offered (billion board feet)	4.0	0.0	0.0	4.0
Acres of NFS Land Treated for Fuels Management	131,254.5	0.0	887,145.0	1,018,399.5
Miles of land line location	877.7	0.0	0.0	877.7
Acres of Land Exchange Fee and Partial Interest	244,177.9	0.0	0.0	244,177.9
Acres of Land Ownership Adjustment excluding exchanges	102,994.3	0.0	0.0	102,994.3
¹ Appropriated funding includes current year Congressional appropriations and funding carried over from the previous fiscal years. ² All performance measures are estimated or qualified.				

II. Performance Highlights

Restoration of Wildlife and Fish Habitat

In FY 1997, using appropriated funding the Forest Service accomplished 206,067.2 acres of wildlife habitat restoration or enhancement, constructed 3,444.8 habitat improvement structures, restored or enhanced 6,631.4 lake acres and 950 stream miles of inland fish habitat, and an additional 3,713 lake acres and 900.3 stream miles of anadromous fish (saltwater fish that migrate upriver to spawn) habitat. A variety of structural and nonstructural improvements were performed including installation of fish passages at migration barriers, placement of logs and rocks to create nesting areas and trap spawning gravel to re-establish vegetation to protect eroding stream banks.

Threatened, Endangered, and Sensitive Species Habitat Improvement

The Forest Service accomplished 122,280.7 terrestrial acres, 118.3 aquatic acres and 161.2 stream miles of threatened, endangered, and sensitive species habitat restoration or enhancement and constructed 2,912 habitat improvement structures with appropriated funding. Key accomplishments include: broad management strategies for species now at risk in many grassland, wetland, and forested riparian ecosystems; aquatic resources restoration; and native plant restoration.

Vegetation Management to Maintain Healthy Forests and Provide Other Benefits

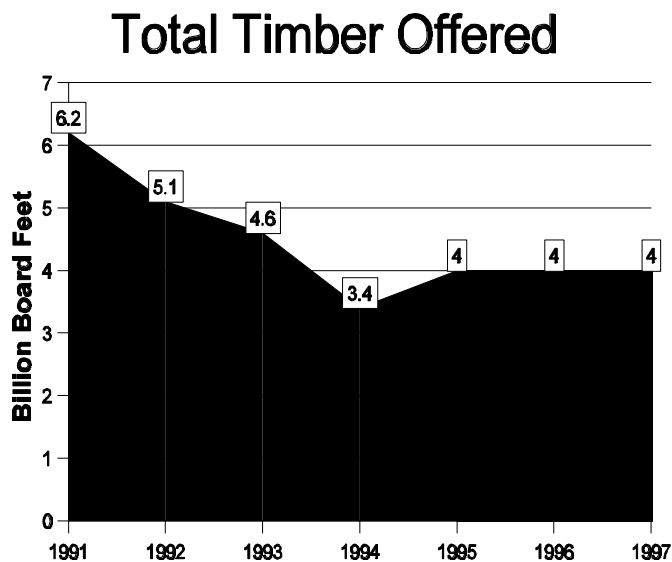
Approximately 321,498 acres of NFS land were reforested, primarily using genetically improved seedlings. Aggressive reforestation practices continue to ensure that NFS land remain productive to provide for healthy ecosystems and to meet other land management objectives. Timber Stand Improvement (TSI) treatments on NFS land totaled 257,881 acres. TSI activities include timber stand release, pre-commercial thinning, pruning, and fertilization. Reforestation and stand improvement treatments continue to decline as a result of timber harvest reductions and a decreasing proportion of regeneration harvest acres to total harvest acres.

The number of acres treated annually through the regular and salvage timber sale programs is indicative of the extent of maintenance and restoration of forested ecosystems on NFS land and the implementation of forest plan goals and objectives. Timber sales are usually designed to incorporate multiple objectives, which may include insect and disease control, fuels treatment, and habitat restoration in addition to the production of wood. Because of this, reporting accomplishments in terms of acres treated better reflects the work being done to accomplish these objectives. Harvest treatments were employed on 458,000 acres, compared with 473,000 acres in FY 1996. The decrease reflects a reduced timber sale program and the shift from regeneration harvests, especially clear-cut. Total clear up acreage declined from 56,617 acres in FY 1996 to 45,854 acres this past year. The use of clear cutting as a standard commercial harvest method has declined over the past several years.

Forage Production

In FY 1997, analysis processes were continued on grazing allotments. Work was completed and decisions implemented on 621 allotments. The program reflects an ecosystem perspective emphasizing restoration and the long-term health of rangeland.

Noxious weeds were treated on 72,357.6 acres. The Forest Service, as the designated lead agency for noxious weed activities within USDA, coordinates the USDA noxious weed strategy. The strategy identifies priority action items and agency responsibilities, and outlines opportunities for cooperation to ensure an efficient and cost-effective approach to noxious weed management. A partnership, "Pulling Together," continued between the Department of the Interior, the National Fish and Wildlife Foundation, and USDA to leverage funds through cost-share challenges to neighbors and partners. This program encourages the formation of local partnerships to prevent and manage noxious weeds by group consensus across jurisdictional boundaries in a cost-efficient manner, to restore ecosystem health and bio-diversity, and to ensure future productive use of the natural resources present.



Wood Fiber Production

The Forest Service offered 4.0 billion board feet (BBF) of timber for sale and sold 3.7 BBF from NFS land. Salvage volume accounted for 1.7 BBF of the amount offered. Volume harvested on NFS land was 3.3 BBF. This provided a continuing supply of forest product, within the capabilities of the ecosystem benefitting local communities.

Protecting Soil and Watershed Resources

Soil Resource inventories were completed on 4.7 million acres. These inventories combine soils with related vegetation, geology, land form, and climate to assess inherent capability and predict the impacts of potential management actions. Watershed conditions were improved on 63,572.6 acres of National Forest System land. These treatments included re-vegetation of denuded areas, reshaping erosion prone land, and controlling runoff.

In partnership with other Federal agencies, the Forest Service developed interagency protocols for updated procedures for conducting watershed assessments. These protocols provide a framework for analyzing the hydro-logic condition of watersheds and ensure consistency within and across agency boundaries so that results of watershed assessments can be aggregated or dis-aggregated easily.

Protecting, Maintaining, and Restoring Ecosystem Health

The Forest Service's highest priority is to restore and protect the health of the Nation's forest and rangeland ecosystems for future generations. Through several efforts, we worked to achieve this priority:

The Forest Health Monitoring Program expanded its network of permanent observation plots to include the States of Oregon and Washington. Fifty-one percent of the forested area of the lower 48 states was monitored as part of this program, compared to 40 percent in 1996. The program, conducted in cooperation with State forestry agencies, provides data on long-term trends in forest health for early detection and diagnosis of changes in condition.

Along with the Animal and Plant Health Inspection Service (APHIS), the Forest Service assisted in eradicating the Asian Long Horned Beetle in New York. Spread of this insect could have resulted in significant economic, social, and ecological impacts on urban, rural, and forest areas in North America.

Detection and evaluation surveys on 203,000 acres of Federal land (162,000 acres on NFS land and 41,000 acres on other Federal land), were completed. Surveys were also completed for 569,000 acres of Cooperative State and private land. Survey findings, recommendations, and advice about suppression needs and available alternatives were provided to land managers.

The Forest Service, in conjunction with other Federal agencies suppressed and prevented the spread of gypsy moth, southern pine beetle, dwarf mistletoes, and other insects and diseases on 1.2 million acres of Federal land.

The spread of gypsy moth was slowed by 60 percent from the historic rate of spread in the Gypsy Moth Slow-the-Spread pilot test conducted in Virginia, West Virginia, and North Carolina,

The Forest Service funded a total of 32 pilot and demonstration projects to assess the use of pesticides for controlling non-native species and the impact on native plants and animals. The Forest Service researched the use of biological controls to limit the spread of noxious weeds and insects including the woolly adelgid.

Fuel reduction treatments (prescribed burning and mechanical methods) were completed on 1,018,399.5 acres of NFS and adjacent land. An additional 3,360 acres were treated by the use of contributed funding.

The Fire and Aviation Management program initiated FIRE 21, part of the Federal Fire Policy. Under FIRE 21 the agency promotes firefighter and public safety, supports the role of fire in restoring and sustaining healthy ecosystems, and integrates fire and aviation management into the land management planning process.

Landowner Assistance to Provide for Healthy and Vital Ecosystems Communities The Forest Stewardship Program (FSP) and Stewardship Incentive Program (SIP) provide technical and financial assistance to nonindustrial private landowners. Utilizing this assistance private landowners developed and implemented multi resource management plans to protect, manage, and use their natural resources. A total of 2.1 million acres were enrolled under FSP in FY 1997. Another 2.1 million acres were enrolled in forest resource management plans. Thanks to the strong Federal/State cooperation, trees were planted on over 867,000 acres. This represents an increase of over 106,000 acres from FY 1996.

Stewardship Incentive Program The Idaho and Washington Forest Stewardship Committees jointly received the "Forest Stewardship State of the Year Award" from the National Woodland Owners Association for a SIP-supported effort to increase forest management coordination across two watersheds overlapping Idaho and Washington States. The Idaho Department of Lands and Washington Department of Natural Resources assisted woodland owners in each watershed to meet and identify resource management priorities. SIP allocations were determined based on these priorities. Over 250 landowners participated in a one-day field workshop to review innovative stewardship projects and discuss solutions to common problems. As a result, coordination across the watersheds has increased and more landowners enrolled in the Forest Stewardship Program. An additional 112 Landowner Forest Stewardship Plans and 72 SIP practices were completed due to these efforts.

Forest Legacy Program This program continues its success in protecting private forest land from conversion to non-forest uses. Most funds are provided to the states for land purchases, conservation easements, and donations. In FY 1997, Legacy purchases protected an additional 43,478 acres of forest land across the United States.

Through a collaborative effort with King County, Washington State, the Mountains to Sound Greenway Trust, and the Trust for Public Land, the Forest Service purchased 840 acres in the Mountains to Sound Greenway east of Seattle. King County is developing recreational and management projects for the land. Under one innovative proposal, approved by the Environmental Protection Agency, King County will fertilize the forest with wastewater biosolids and conduct sustainable harvesting, while supporting healthy and enjoyable recreational opportunities.

International Programs The Forest Service promotes the sustainable management of forests both domestically and internationally. As part of this effort, the Forest Service participates in collaborative assistance and scientific studies on common forest management problems. U.S. perspectives are incorporated into important multi-lateral international documents and agreements. The Forest Service also lends its disaster assistance expertise to countries in need.

The Forest Service provided assistance to revamp timber sales methods in Honduras that immediately stimulated higher and more efficient yields in harvested volumes. In partnership with the Tropical Forest Foundation (TFF), and based on joint TFF and Forest Service reduced impact logging research, the agency conducted three training courses for Brazilian loggers, government officials, and local organizations. The success of the training led the International Tropical Timber Organization (ITTO) to fund the training for other Amazonian countries. The Indonesian government has requested similar training in reduced impact logging training.

In Russia, seven weeks of training in efficient greenhouse management resulted in the production of 420,000 containerized Siberian pine seedlings. This compares to 8,000 seedlings produced in 1995. Further use of this technology will enable the Russian foresters to pre-plant extensive areas of poorly stocked forest land.

The Disaster Assistance Support Program provided services (totaling 137 person weeks) in Yugoslavia, Rwanda, Sudan, Peru, and southern Africa. Through the program the agency also trained about 400 United States Agency for International Development (USAID), Department of Defense, and Public Health personnel in international disaster assessment and response.

Urban and Community Forestry (U&CF)

In collaboration with other Federal agencies, State agencies, non-profit and community groups, and educational institutions, the U&CF program provides management expertise, technology, matching grants, and financial support for program development to build local capacities for community forest ecosystem management. Through these joint efforts, the Forest Service offers technical and financial assistance to local managers to assess, improve, and expand forests in metropolitan areas, which encompass 80 percent of the Nation's population.

To assist in building local community capabilities, technical and financial assistance was provided to 10,110 communities in FY 1997.

Additional communities are at the "formative" stage of program development and they engage in networking, public awareness building, establishment of local tree boards, and preliminary assessments of urban forest resources.

Grants made available through Federal funding from this program totaled \$9.9 million and supported a full range of program development activities from national to local. Matching grants generated \$49 million in funds, goods and services supporting tree planting, care and protection.

Recreational Use of the National Forests

The Forest Service manages over 23,000 developed facilities, including campgrounds, trail heads, boat ramps, picnic areas, and visitor centers, in addition to permitted, privately-owned facilities. These facilities can accommodate approximately 2.1 million daily visitors.

In FY 1996, the Forest Service, along with other agencies, began developing a National Recreation Reservation Service (NRRS) that improves the public's ability to reserve Federal recreation facilities. In FY 1997 a new state-of-the-art national reservation system with Internet access was developed to enhance customer service.

Based on data from the National Ski Area Association; the Forest Service estimates 51 percent of all downhill skiing in the United States occurs on NFS land. In cooperation with the 135 ski area operators, through the National Winter Sports program the national forests provided downhill skiing opportunities to approximately 26.6 million people in FY 1997. In FY 1997 the Forest Service worked very closely with the ski industry to implement a new ski fee system passed by the 104th Congress. The first new ski area, since 1978, was allowed to operate on NFS land in Montana.

Interpretive Services

During FY 1997 12 million people visited Forest Service visitor centers and interpretive sites to learn about cultural and natural resources of the national forest land. These interpretive programs work closely with other public outreach and environmental education programs to forge links between the American public and their natural and cultural heritage.

Accessibility

The agency continued interagency development of the Universal Trails Project to provide important trail information for all trail users, regardless of age or ability. The project was developed under a Federal grant by Beneficial Design Inc., and is being implemented through partnership with them and other Federal and State agencies.

The Forest Service began participating in a Regulatory Negotiation committee for the US Architectural and Transportation Barriers Compliance Board to determine accessibility requirements in outdoor recreation areas including campgrounds, picnic areas, beaches and trails.

Congressionally Designated Areas

Almost 23 percent of NFS land is included in areas of special Congressional designation, such as wilderness, wild and scenic rivers, national recreation areas, national monuments, and other designations. These areas encompass some 43 million acres of NFS land that are managed with attention to the specific Congressional mandates found in the laws creating them, and their special values and unique contributions to both current society and future generations.

Heritage Resources

The Heritage program protects the historic and cultural heritage of NFS land and shares related information with the public for its enjoyment and education. In FY 1997, a total of 5,763 heritage properties were preserved through restoration, rehabilitation, stabilization, and repair in order to extend their existence and availability to the public.

Windows on the Past is a public access interpretive initiative designed to increase public participation in heritage activities on NFS land. In FY 1997, 935 new public interpretive projects were completed, and 1,318 new public outreach efforts were made to educate and inform the public about heritage values on NFS land.

During FY 1997, approximately 2,328 volunteers contributed 81,480 hours through Passport In Time (PIT) projects. Working with agency archaeologists, these volunteers restored historic structures, evaluated heritage sites, surveyed for sites in wilderness, monitored and restored sites damaged by looters or natural elements, developed interpretive materials, helped with classroom projects and served as public hosts at historic interpretive facilities.

Minerals Production

The Forest Service administers energy and mineral resource exploration, development, and production from National Forest System land. Seeking to foster and encourage energy and non-energy mineral activities on National Forest System land in an environmentally acceptable manner, 961 bonded non-energy operation plans and 455 energy operation plans were processed in FY 1997.

Rural Community Assistance

In FY 1997, 2,205 rural communities, including over 130 tribes and minority communities, received direct technical and financial assistance through the Rural Community Assistance (RCA) effort. In addition to these communities, over 1,050 organizations and enterprises also received assistance. The RCA helps to build skills, knowledge, and abilities within communities which desire to be more self-sufficient and practice good natural resource stewardship.

Forest Products Conservation Recycling

The Forest Products Conservation and Recycling program (FPC&R) provides technical assistance to communities and businesses that fosters conservation through proper utilization of forest products including efficient processes, marketing, and recycling. Creating or adding economic value for previously undervalued tree species has a positive effect on protecting public and private land ecosystems by providing new market-based incentives to manage forest land economically.

Providing Scientific Information and New Technologies

Forest Service Research provides the scientific information and new technologies to manage and sustain the natural resources of the Nation's 1.6 billion acres of forests and rangeland. In FY 1997, the agency produced research outputs, including books, papers, reports and audiovisual materials. The program of research is focused on vegetation management and protection; wildlife, fish, water and air sciences; resource valuation and use; and, forest resources inventory and monitoring.

Collaboration with the National Science Foundation was instrumental in developing the first long-term ecological research projects in urban America, with studies in Baltimore, MD and Phoenix, AZ.

Scientists developed new technologies to spur energy efficiency and reduce greenhouse gases by sequestering carbon in long-lasting wood products. White-rot fungi were used to pre-treat wood chips prior to mechanical pulping, providing the potential to save 30% of the electrical energy used in paper production.

Scientists contributed to the Tongass National Forest risk assessments for wildlife viability, fish habitat, alternatives to clear-cut timber harvesting, and social and economic concerns. Guides, models, and handbooks for watershed analysis and management of the Pacific Northwest Plan were completed.

Exotic pest research was expanded to address rangeland pests. Scientific information on the biology of Asian Long-horned beetles supported eradication efforts. Newly developed DNA markers for viral control agents led to more efficient and cost-effective control of the recently introduced Asian Gypsy Moth.

Studies supported improved water quantity and quality, and aquatic ecosystem health,

throughout the U.S. Stream flow management plans are now available for areas in the western U.S., where diminished flows of streams and rivers threaten the completion of life cycles for fish and other aquatic organisms. Impacts from fire, logging, roads, grazing, and recreation on fisheries and aquatic habitat were documented.

Habitat management information and guides for more than 70 threatened, endangered, and sensitive species have been developed. These efforts help define forest fragmentation impacts on wildlife, and support species such as the grey wolf.

Prescriptions were developed for use of fire to restore pine and oaks in the southern Appalachians, with minimal loss of soil nutrients.

Research collaboration showed that ozone reduced white pine growth in Arcadia National Park. Ozone effects were greater than the normally dominant factors of temperature and precipitation. Other atmospheric research demonstrated the positive effects of trees in urban environments. Trees decreased the concentrations of ozone and other pollutants in Philadelphia, PA and Chicago, IL.

Partnerships in Recreation Programs

In FY 1997, the agency continued to build momentum in attracting and sustaining partnerships. These partnerships expand agency capability to accomplish recreation, heritage, and wilderness objectives; to develop a knowledgeable, supportive constituency; and to foster collaborative stewardship. To support this agency-wide emphasis the field friendly "Partnership Guide" was created to help employees navigate through the partnership community of corporate America, non-profit organizations, and government agencies at all levels. New training has been developed to support this alternative way of getting work accomplished. The agency is experiencing a noticeable organizational shift as units create partnership positions and become more entrepreneurial.

As the Forest Service continues to increase partnerships, the tool of choice will be special uses to deliver the recreation experience to the public. To accommodate this expected workload increase, NFS has embarked on a National effort to streamline the permit system and rewrite regulations where necessary.

The Forest Service cooperated with the Western States Tourism Policy Council to develop a memorandum of understanding (MOU) to guide Federal and State tourism planning and promotion efforts. The MOU was signed on September 22, 1997. Major progress was made in implementing government efforts for the Northern California Tourism Strategy through cooperative funding of a new tourism extension agent and welcome center.

Partnerships in Wildlife, Fish, and Rare Plants Programs

The Forest Service accomplished a significant share of wildlife, fish, and rare plant habitat management through partnerships with over 1,800 organizations and agencies, such as the National Fish and Wildlife Foundation, Rocky Mountain Elk Foundation, National Wild Turkey Federation, Trout Unlimited, Ducks Unlimited, The Nature Conservancy, other Federal resource agencies, 44 State fish and wildlife agencies, and 43 State natural heritage inventory programs. About one-quarter of the wildlife, fish and Threatened and Endangered Species habitat management program is accomplished by our partners through the challenge cost-share program.

Providing Quality Information Support Sound Decisions The Meaningful Measures process (MMP) is a recreation management concept that sets standards of quality for all aspects of the Recreation program (facilities, sites, areas, etc.), determines realistic costs, helps prioritize work, assists in budget allocation, and sets the stage for effective monitoring of results. In FY 1997, training of field units in the MMP was completed. Refinement of the process is continuing while implementation has begun at the forest level.

Financing Recreation Services The Interior and Related Agencies Appropriation Act of 1996 (P.L. 104-134) authorized the development of up to 50 recreation fee demonstration projects. Authorization for 50 more projects and a one-year extension was given under the Interior Appropriation Act for FY 1997 (P.L. 104-208). Currently 83 projects have been selected from 25 States and Puerto Rico. Public support runs close to 4 to 1 in favor of the fee program where the dollars are spent on the sites where they are collected.

Real Estate Management Real estate management includes such activities as boundary management (surveys), land exchange, special use administration, establishing and protecting the United States' title, resolving encroachments, and maintaining accurate landownership records.

The Hydro-power Re-licensing Initiative was adopted in April 1997, to respond to a significant increase in workload due to the re-licensing of over 180 Federal Energy Regulatory Commission (FERC) licensed projects on NFS land. Beginning in 1998, the FS will be faced with a workload of 78 such projects..

Land exchanges between NFS and other ownerships are needed to protect key resources, eliminate conflicting uses, and reduce fragmented ownership. The Forest Service completed equal value exchanges involving 133,046 acres of NFS land for 244,177.9 acres of non-Federal land in FY 1997. Much of the non-Federal land acquired through land exchanges lies within classified wilderness areas, national recreation areas, wild and scenic river corridors, national trails, and other congressionally designated areas. The acquired land include thousands of acres of critical wildlife habitat, wetland, and riparian areas. These exchanges resulted in adjustments to 1,000 miles of NFS property boundary lines, saving approximately \$5.0 million in future land line location costs.

The boundary management program is that group of activities which defines and protects the public estate administered by the Forest Service. This program is responsible for describing, surveying, and locating the legal boundaries between NFS land and other ownerships for the purposes of protecting the land and resources of the public estate, as well as the adjoining owners. In previous years this program has been funded primarily with land line location activity funds. Beginning in FY 1995 the boundary management program was also funded with benefitting function activities. In FY 1997, 877.7 miles of boundary line were surveyed and located using land line location appropriated funds and an additional 185.0 miles were accomplished with other benefitting funds and 54.6 miles were accomplished through contributed funding. A total of 1,118.3 miles were surveyed and located with funding from all sources.

The Forest Service acquired 102,994.3 acres with appropriated funds and an additional 28.6 acres from contributed funding. The acres acquired are needed to protect critical wildlife habitat, cultural and historical values, congressionally designated areas, and other outdoor recreation and conservation purposes.

The non-recreation special use program authorizes the operation of over 137 different types of activities on NFS land. These activities provide benefits to other Federal, State, and local governments; commercial and industrial entities; and private individuals. Many special use permits authorize the operation of facilities and services necessary for public health, welfare, safety, convenience, and national security, such as pipelines, highways, communications, and telephone lines. These authorizations may be of short or long-term duration, and generally involve substantial financial investment by the permit holder. Law and regulation require the Forest Service to collect annual rental fees based on fair market value. This value is determined by appraisal, negotiation, prospectus and bid, or other sound business management practice. In FY 1997, the Forest Service and the Bureau of Land Management adopted and implemented identical fee schedules, authorization documents, and similar policies for the administration of communications uses on NFS and BLM administered land. Consistency between agencies has improved service to the communications industry.

**Providing Access to the
were National Forests**

In FY 1997, 403.4 miles of new roads were constructed. A total of 1,790.0 miles obliterated. This included 551.1 miles from appropriated funding, 305.1 miles from contributed funds, and 930.8 from other benefitting funds. The agency constructed 23 new bridges and reconstructed 43. Much of the road system required to meet public and administrative needs on the national forests is currently in place. The future emphasis of the road program is toward reconstruction to mitigate environmental impacts, ensure safe use of the existing road system, and toward road obliteration. Road obliteration will be used when roads can no longer be maintained to standard, are considered unnecessary and too costly, and where removal is necessary to protect the ecosystem.

The Remote Sensing Applications Center (RSAC) coordinated a national purchase of satellite imagery covering the coterminous United States. This procurement was sponsored by the Interregional Ecosystem Management Coordination Group for use in Large Area Analysis and forest plan revisions. The satellite images will be used to map vegetation-land cover and detect change. RSAC also completed a report which provided guidelines, standards and recommendations on how to prepare consistent products using satellite imagery. RSAC provided training and technical support to Forest Service field offices on using remote sensing technology.

**Environmental Compliance
Projects**

Significant progress was made in the Forest Service hazardous substances and hazardous waste programs. The Forest Service completed 26 removal actions at hazardous substances sites; bringing the total number of removal actions completed to over 300. Negotiations are ongoing with parties responsible for pollution at several sites, and settlements were completed at five sites. To date, the Forest Service has reached settlement agreements at seven sites. At these sites, the responsible parties undertook response actions which have resulted in a cost avoidance to the government of over \$39 million. The underground storage tank removal program is almost complete with the exception of ongoing remediation at about 9 sites where tanks have

leaked. Over 1,600 tanks have been removed since 1988.

Human Resource Programs

The Forest Service continues its commitment to provide work, volunteerism, training and educational opportunities to the unemployed, underemployed, elderly, youth and others with special needs.

The Forest Service, in partnership with the Department of Labor, operates 18 Job Corps civilian conservation centers (16 of which are co-educational). The Forest Service has been a major Job Corps program operator for over 30 years. Job Corps is the only Federal residential, educational, and training program for the Nation's disadvantaged youth between the ages of 16-24 years old. The purpose of the program is to provide the skills necessary to obtain and hold a good job at a living wage. The program goals are accomplished in a structured residential environment which provides education, vocation and social skills training, counseling, social development, medical care, placement assistance, and an allowance.

The Job Corps centers accomplished work on conservation areas as recreation, facilities and road construction, water and soil improvement, range management, and fire prevention and suppression. The centers placed 4,176 graduates in jobs that lead to career ladders with an average starting wage of \$6.14 per hour.

The Job Corp enrollees learn trades such as basic forestry, urban forestry, heavy equipment operation and maintenance, cement and brick masonry, auto mechanics, carpentry, welding, culinary arts, plastering, painting, business occupation skills, dispensing optician, health services, and security guard.

The Volunteers program offers individuals and sponsored groups or organizations the opportunity to contribute their talents and services to assist in managing the Nation's natural resources. The international component to the Volunteers program continued with regions hosting participants from 12 different countries. Volunteer participation increased significantly in FY 1997. A total of 112,384 volunteers assisted in the management of NFS land, of which 129 were international participants.

The Youth Conservation Corps provides eight weeks of summer employment for 15-through 18- year-old youths. Youths earn and learn while performing conservation and maintenance work on NFS land.

The Forest Service continued its Youth Forest Camp program for the fifth year. Under the Youth Conservation Corps authority (P.L. 93-408) and through a partnership with the National Forest Foundation, the agency operated one Youth Forest Camp, Camp TIPS, in Colorado during the summer of 1997. The Camp served 25 enrollees, ages 14-20, of which 44 percent were women. The enrollees completed resource projects in recreation, range and timber management on NFS land. They also learned skills to cope with every day pressures and received environmental education.

The Senior Community Service Employment program provides part-time employment and training opportunities for disadvantaged enrollees aged 55 and older. In FY 1997, a total of 5,055 enrollees upgraded their work skills through a variety of projects and training programs. Over 18 percent of the funded positions were placed

in unsubsidized employment.

Law Enforcement and Investigations

The Law Enforcement and Investigations (LE&I) program mission is to serve people and protect natural resources and property within the authority and jurisdiction of the Forest Service.

Special Agents opened 1,201 investigations and closed 338 felony and serious misdemeanor crimes for both resource violations and internal/hotline complaints.

In FY 1997, the funding of 546 regular cooperative law enforcement agreements allowed the Forest Service to work closely with State and local law enforcement agencies and with other Federal agencies. Another 171 drug control agreements were negotiated to cooperate in combating illegal drug activities on NFS land.

**Employee Satisfaction
Continuous Improvement
Process**

In FY 1997 the Forest Service conducted an employee survey to assess how practices, procedure, and policies are working in the organization. The survey highlights strengths and areas for improvement in the organization. The 1997 survey gathered baseline data to track change over time through the use of subsequent surveys. Service-wide, 38,318 questionnaires were distributed to employees; and 21,508, or 56 percent were returned.

Acquisition Management

The agency spent approximately \$ 700 million for goods and services in FY 1997. Over 72 percent of total contract and purchase order dollars went to small businesses. Awards included more than \$ 49 million to small disadvantaged businesses and \$ 29 million to women-owned firms.

**Information Resources
Management**

The Forest Service is moving toward an integrated environment for all information related to managing all program areas. The Forest Service Information Management Framework provides an acquisition vehicle for hardware and software for all Forest Service offices for geographic information systems (GIS) and replacement systems for the old Data General technology. The objective is to implement easy-to-use technology service-wide, which will facilitate the access, use, and sharing of management information about resources to help the Forest Service achieve its mission.

Full implementation of the IBM started in the third quarter of FY 1997 and will continue until everyone has access to and training on the new technology.

III. FINANCIAL PERFORMANCE

Financial statements included in this report have been prepared to report the financial position and results of operations of the Forest Service, pursuant to the requirements of the Chief Financial Officers Act of 1990.

Limitations of Financial Statements

These statements have been prepared from the books and records of the Forest Service in accordance with the formats prescribed by the Office of Management and Budget (OMB). The reader should be aware that these statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that:

- * they are for a sovereign entity;
- * unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and;
- * the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

Improvements in Financial Management Information

Forest Service financial statements have previously been audited by the General Accounting Office (GAO) and the United States Department of Agriculture Office of Inspector General (USDA-OIG). Some weaknesses were noted and actions have been initiated to correct them.

These audits have provided valuable information about Forest Service accounting systems and how these systems are being used. The awareness of these issues, and subsequent corrective actions, are positive outcomes related to implementation of the Chief Financial Officers Act of 1990. That is, to "bring more effective general and financial management practices to the Federal Government."

The Forest Service is working with the Department of Agriculture's Office of Finance and Management on multi-year, Department wide projects titled "Modernization of the Administrative Process" (MAP) and a "Financial Information and Vision Strategy" (FISVIS). One of the accomplishments of these projects will be to bring the Forest Service accounting systems into compliance with Generally Accepted Accounting Standards (GAAP).

The Forest Service also supports the Department's Foundation Financial Information System (FFIS) which is a single, integrated, real time financial system. Our current financial structure is so complex that we are unable to keep all of our existing financial system in sync well enough to produce reliable, timely, and accurate financial information. Our inability to produce timely, reliable, accurate financial information has in the past hurt the ability of management to use auditable financial information in the decision-making process. The Pacific Northwest and Alaska Regions and the Pacific Northwestern Station began using FFIS in October of 1997.

In 1997, the Forest Service began a quarterly analysis of obligations. Mis-

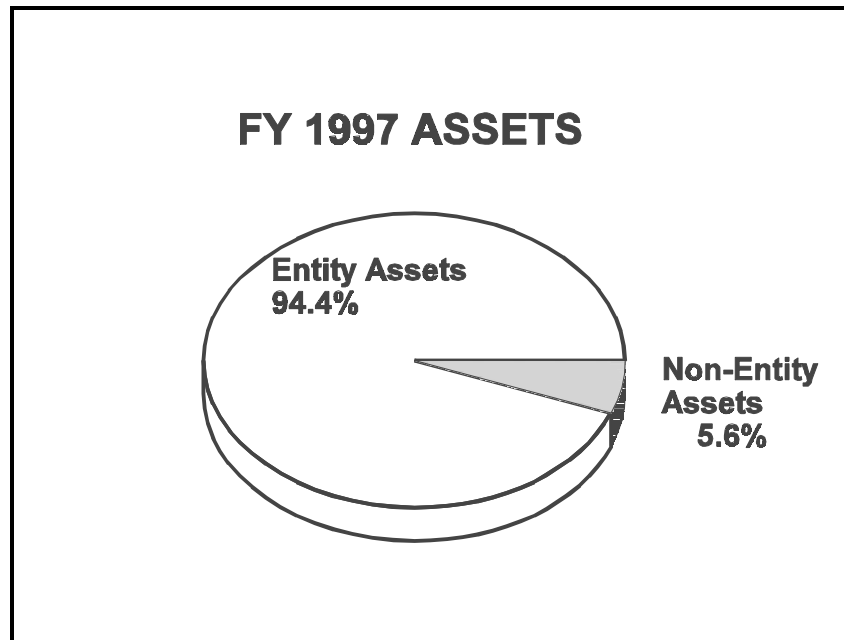
classification of obligations had been one of the major findings in previous financial statements. Also, the Financial Health Task force which included participants from the USDA Office of the Chief Financial Officer, the USDA Office of Inspector General, and the Forest Service concentrated their efforts on 5 key issues which became the outline for the Financial Health Desk Guide. The key areas are management and accountability, accounts receivable and reimbursements, accounts payable, real property, and cash and unexpended appropriations. As part of the Financial Health effort, the Office of Inspector General began monitoring work during the summer of 1997. Their monitoring reports recognized that "significant improvement" had been made in our financial health efforts.

In 1997, the Forest Service continued its efforts in the development and implementation of the Infrastructure System designed to track and manage our real property inventory. The system is designed to meet resource information needs as well as financial requirements.

Reporting standards for performance measures have been developed and published and distributed to the field offices. The instructions include description of the measure and when an accomplishment is counted and reported in the Management Attainment Reporting system.

*Statement of
Financial Position*

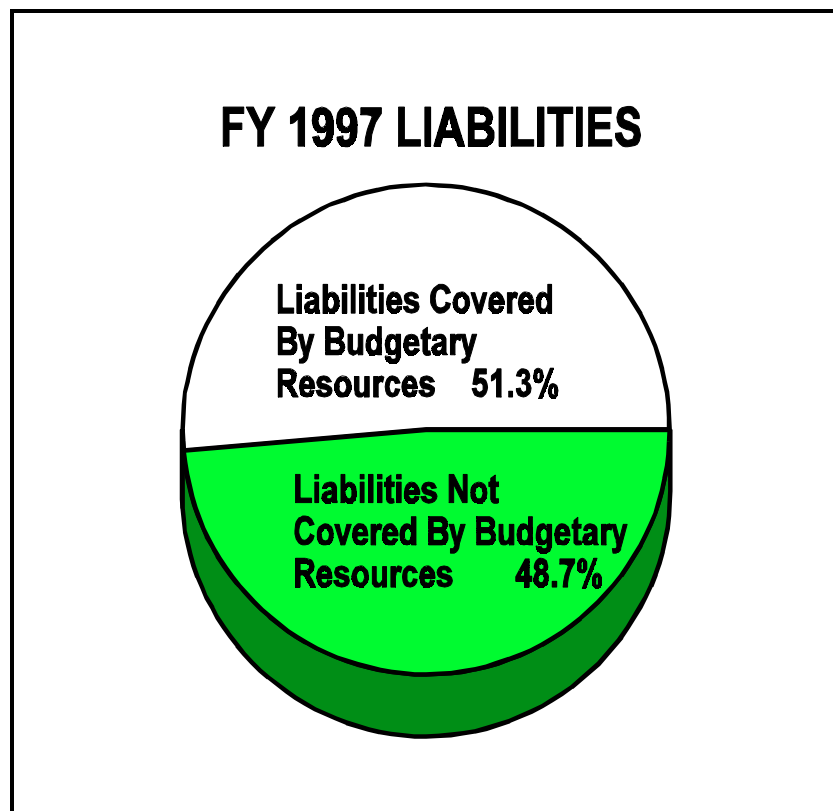
Forest Service assets are recorded in two broad categories, Entity Assets and Non-Entity Assets. Entity Assets are assets which the Forest Service has authority to use in its operations. Non-Entity Assets are held by the Forest Service. They consist primarily of funds at the U.S. Treasury awaiting transfer to the General fund but are not available for Forest Service use. As displayed in the following chart, Entity Assets, comprised primarily of Property, Plant, and Equipment, exceed Non-Entity Assets.



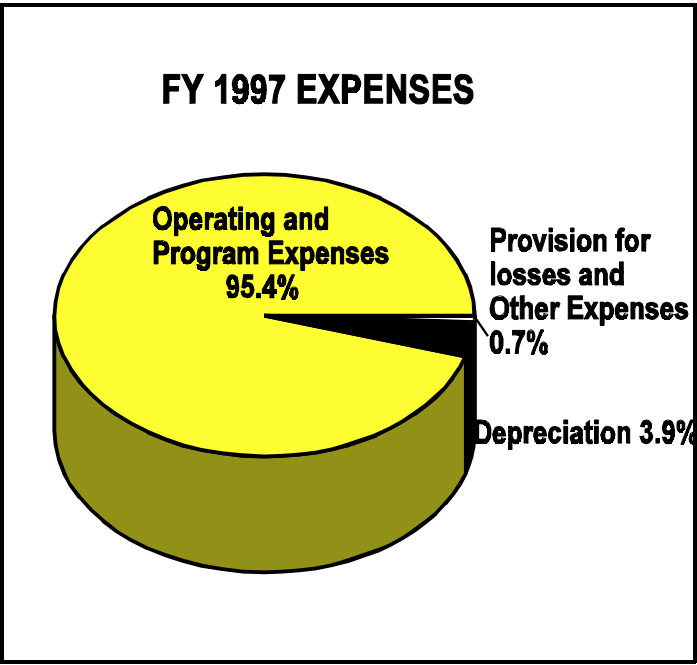
Liabilities associated with Forest Service operations are also divided into two broad categories as displayed in the following chart. Liabilities Covered By Budgetary Resources are liabilities incurred which will be covered by available budgetary resources.

The largest portion of these liabilities (approximately 30.1% of \$ 1.1 billion) is due to Non Federal accrued Program Liabilities which is comprised of amounts payable to States and Counties in accordance with Public Law 60-136 requiring the Forest Service to pay a portion of receipts from timber, recreation, and other product sales to the States and Counties where National Forests and Grasslands are located. Other sources of these liabilities include Accounts Payable, Trust and Deposit Liabilities, and Unearned Revenue.

Liabilities Not Covered By Budgetary Resources include liabilities for which revenues or other sources of funds have not been made available through Congressional appropriations or current earnings. The largest portion of these liabilities (approximately 51.7% of \$1.0 billion) is due to a liability for Accrued Annual Leave and Federal Employees Compensation Act Liability, reported under the Non-Federal Liability category. Additional sources of these liabilities include fire fighting advances from the unobligated balance in the Knutson-Vandenberg (KV) Trust Fund.



Total Forest Service expenses are displayed in the following chart. As shown, Program and Operating Expenses are the largest single category. Expenses associated with programs and operations include amounts related to the National Forest System, State and Private Forestry, Research, Human Resources, and International Forestry.



U.S. Forest Service
Statement of Financial Position
As of September 30, 1997
(dollars in thousands)

Assets	
Entity Assets	
Federal Assets	
Fund Balance with U.S. Treasury and Cash (Note 2)	\$2,323,240
Accounts Receivable (Note 3)	47,845
Non-Federal Assets	
Accounts Receivable, Net (Note 3)	36,104
Advances and Prepayments	3,979
Operating Materials and Supplies, Net (Note 4)	68,338
Property, Plant and Equipment, Net (Note 5)	8,689,494
Total Entity Assets	\$11,169,000
Non-Entity Assets	
Federal Assets	
Fund Balance with U.S. Treasury and Cash (Note 2)	\$602,560
Accounts Receivable (Note 3)	45
Non-Federal Assets	
Accounts Receivable, Net (Note 3)	35,451
Interest Receivable, Net (Note 6)	15,033
Other (Note 7)	3,518
Total Non-Entity Assets	\$656,607
Total Assets	\$11,825,607

The accompanying notes are an integral part of these statements.

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U.S. Forest Service
Statement of Financial Position
As of September 30, 1997
(dollars in thousands)

Liabilities	
Liabilities Covered By Budgetary Resources:	
Federal Liabilities	
Accounts Payable (Note 8)	\$89,309
Trust and Deposit Liabilities (Note 9)	35,889
Resources Payable To Treasury	113,816
Non-Federal Liabilities	
Accounts Payable (Note 8)	173,554
Accrued Program Liabilities (Note 10)	323,388
Unearned Revenue (Note 11)	38,519
Trust and Deposit Liabilities (Note 9)	299,667
Other	59
Total Liabilities Covered By Budgetary Resources:	\$1,074,201
Liabilities Not Covered By Budgetary Resources:	
Federal Liabilities	
Accrued Program Liabilities (Note 12)	\$492,870
Non-Federal Liabilities	
Annual Leave and Federal Employees Compensation Act Liability (Note 13)	527,209
Contingencies and Commitments (Note 14)	
Total Liabilities Not Covered By Budgetary Resources	\$1,020,079
Total Liabilities	\$2,094,280
Net Equity of the U.S. Government (Note 15)	
Unexpended Appropriations	\$1,964,108
Invested Capital	8,369,416
Donated Capital	103
Cumulative Results of Operations	417,779
Total Equity of the U.S. Government	\$10,751,406
Less: Future Financing Sources	\$1,020,079
Total Net Equity	\$9,731,327
Total Liabilities and Net Equity	\$11,825,607

The accompanying notes are an integral part of these statements.

See Accountant's Compilation Report

U.S. Forest Service
Statement of Operations and Changes in Net Position
For the Fiscal Year Ending September 30, 1997
(dollars in thousands)

Revenues	
Revenues from Sales of Goods and Services	
Non-Federal (Note 16)	\$686,743
Interest and Penalties	
Non-Federal	15,033
Other Revenues (Note 17)	25,056
Less: Receipts Transferred to the U.S. Treasury or Other Agencies	113,816
Total Revenues	\$613,016
Other Financing Sources	
Appropriated Capital Used	\$2,715,162
Reimbursements	130,994
Other Financing Sources (Note 18)	291,039
Total Other Financing Sources	\$3,137,195
Total Revenues and Other Financing Sources	\$3,750,211
Expenses	
Operating/Program Expenses (Note 19)	\$3,534,014
Provision for Losses (Note 20)	(8,788)
Depreciation and Amortization	143,133
Other Expenses (Note 21)	35,378
Total Expenses	\$3,703,737
Excess (Shortage) of Revenues and Other Financing Sources Over Total Expenses Before Extraordinary Items	\$46,474
Extraordinary Items (Note 22)	(\$140,000)
Excess (Shortage) of Revenues and Other Financing Sources Over Total Expenses	(\$93,526)
Net Position, Beginning Balance, as Previously Reported	\$7,377,721
Adjustments (Note 23)	124,899
Net Position, Beginning Balance, as Restated	\$7,502,620
Excess (Shortage) of Revenues and Other Financing Sources Over Total Expenses	(93,526)
Plus (Minus) Non-Operating Changes: (Note 24)	2,322,233
Net Position, Ending Balance	\$9,731,327

The accompanying notes are an integral part of these statements.

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U.S. FOREST SERVICE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS
(dollars in thousands)

September 30, 1997

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These financial statements were prepared to report the financial position and results of operations of the Forest Service, as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the Forest Service in accordance with the form and content for entity financial statements specified by Office of Management and Budget (OMB) Bulletin 94-01, and U.S. Department of Agriculture (USDA) and Forest Service accounting policies which are summarized in this note. These statements are therefore different from other financial reports prepared by the Forest Service pursuant to OMB directives, which are used to monitor and control the Forest Service's use of budgetary resources.

The Forest Service also does not provide a Statement of Cash Flows or a Statement of Budget and Actual Expenses. These statements are no longer required by USDA.

B. Reporting Entity

The Forest Service was established on February 1, 1905, as an agency of the United States within the USDA, for the purpose of maintaining and managing the nation's forest reserves. It operates under the guidance of the Under Secretary for Natural Resources and Environment. Forest Service policy is implemented through nine regional offices, nine research offices, and one state and private forestry area office, with 868 administrative units functioning in 46 states and Puerto Rico.

The Forest Service's mission includes the following activities:

- ! Protection and management of 191.8 million acres of National Forest System land which includes 34.6 million acres of designated wilderness areas.
- ! Research and development of forestry and rangelands management practices to provide scientific and technical knowledge for enhancing and protecting the economic productivity and environmental quality of the nation's 1.6 billion acres of forests and associated rangelands.
- ! Cooperative agreements with state and local governments, forest industries and private landowners to help protect and manage non-federal forests and associated range land and watershed areas.
- ! Partnerships with other nations and organizations in order to foster global natural resource conservation and sustainable development of the world's forest resources.

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U.S. FOREST SERVICE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS
(dollars in thousands)

September 30, 1997

- ! Human resource programs which employ, train, or educate the young, unemployed, underemployed, economically disadvantaged, disabled, and elderly.

The accompanying financial statements of the Forest Service include the accounts of all funds under the Forest Service's control.

C. Revenues and Other Financing Sources

The Forest Service is funded principally through Congressional appropriations and other authorizations from the Budget of the United States. The Forest Service receives both annual and multi-year appropriations that are used, within statutory limits, for operating and capital expenditures. Additional amounts are obtained through reimbursements for services performed for other federal agencies. Also, Forest Service receives gifts from donors and interest on invested funds.

Appropriations are recognized as revenues at the time the related programs or administrative expenses are incurred. Appropriations expended for property and equipment are recognized as expenses when an asset is consumed in operations. Other revenues are recognized when earned, i.e., goods have been delivered or services rendered. The Forest Service is funded by the following appropriations:

<u>Appropriation Number</u>	<u>Appropriation Description</u>
1103	Construction
1104	Forest Research
1105	State and Private Forestry
1106	National Forest System
1111	Forest Service Fire Protection
1114	Emergency Forest Service Firefighting Fund
1116	International Forestry
4605	Working Capital Fund
5004	Land Acquisition
5008	National Forest Fund
5072	Operation and Maintenance of Recreation Facilities
5207	Range Betterment Fund
5208	Acquisitions of Land for National Forests
5216	Acquisition of Lands to Complete Land Exchanges
5219	Operation and Maintenance of Quarters
8028	Cooperative Work Trust Fund
8034	Gifts, Donations, and Bequests for Forest and Rangeland Research

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U.S. FOREST SERVICE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS
(dollars in thousands)

September 30, 1997

8046	Reforestation Trust Fund
9921	Forest Service Permanent Appropriations
9922	Forest Service Permanent Appropriations

D. Basis of Accounting

Transactions are recorded on both an accrual accounting and budgetary basis. Under the accrual basis, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. All significant transfers between Forest Service funds and intra-agency transactions have been eliminated.

E. Fund Balance with the U.S. Treasury and Cash

The Forest Service does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Funds with the U.S. Treasury are primarily trust and appropriated funds that are available to pay current liabilities and finance authorized purchase commitments.

F. Property, Plant and Equipment

Due to a change in accounting estimate affecting personal property, asset values under \$5,000 and the related accumulated depreciation were removed from the Statement of Financial Position as of September 30, 1997. In accordance with Accounting Principles Board Opinion 20, the net book value of the items removed was charged to current-year expense.

Buildings and structures and facilities are depreciated on a straight line basis. Roads are separated into four components: road prisms, surfaces, culverts, and bridges. Road prisms (the road beds) are capitalized as permanent land improvements and not depreciated. Road surfaces, culverts, and bridges are depreciated on a straight line basis. Equipment is depreciated on a straight line basis. Federal Excess Personal Property is valued at zero and not reported.

G. Advances and Deferred Charges

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenditures/expenses when the related goods and services are received.

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U.S. FOREST SERVICE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS
(dollars in thousands)

September 30, 1997

H. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the Forest Service as the result of a transaction or event that has already occurred. However, no liability can be paid by the Forest Service absent an appropriation. Liabilities for which an appropriation has not been enacted are therefore classified as unfunded liabilities and there is no certainty that the appropriations will be enacted. Also, liabilities of the Forest Service arising from other than contracts can be abrogated by the government, acting in its sovereign capacity.

I. Contingencies

The Forest Service is a party in various administrative proceedings, legal actions, environmental suits, and claims brought by or against it. In the opinion of Forest Service management and legal counsel, the ultimate resolution of these proceedings is impossible to determine.

J. Annual, Sick and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of leave are expended as taken.

K. Retirement Plans

The majority of Forest Service employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under the CSRS, the Forest Service withholds seven to 7.5 percent of their gross earnings. The Forest Service matches the employees' contribution and the sum is transferred to the CSRS. The Forest Service does not report CSRS assets, accumulated plan benefits, or unfunded liabilities (if any) applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management.

On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. For employees covered by FERS, the Forest Service withholds, in addition to Social Security, 0.8 to 1.3 percent of gross earnings.

On April 1, 1987, the federal government initiated the Thrift Savings Plan (TSP), which is a retirement savings and investment plan for federal employees covered by both FERS and CSRS. FERS

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employees may contribute up to ten percent of their gross pay to the plan. The Forest Service automatically contributes one percent of a FERS employee's gross salary to the TSP. For the first three percent of gross pay contributed by a FERS employee, the agency will match the contribution dollar for dollar. For the next two percent contributed, the agency will match fifty cents per dollar contributed. CSRS employees may contribute up to five percent of their gross pay, but there is no matching contribution.

The maximum amount that either FERS or CSRS employees could contribute to the plan in fiscal year 1997 was \$9,500. The sum of employee and agency contributions is transferred to the TSP, which is administered by the Federal Retirement Thrift Investment Board.

L. Comparative Data

Comparative data for the prior year have not been presented because financial statements were not prepared by the Forest Service for fiscal year 1996. In future years, comparative data will be presented in order to provide an understanding of changes in the financial position and operations of the U.S. Forest Service.

NOTE 2. FUND BALANCE WITH U.S. TREASURY AND CASH

The Forest Service does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Funds with the U.S. Treasury are primarily trust and appropriated funds that are available to pay current liabilities and finance authorized purchase commitments. Fund Balances with U.S. Treasury and Cash are shown for both entity and non-entity fund balances.

Differences exist between the Fund Balance with the Treasury as reported on the Treasury Year-End Closing Statement (TFS 2108) and the Fund Balance with U.S. Treasury and Cash as reported in these financial statements. Cash receipt and disbursement transactions reported on the TFS 2108 agree with the monthly Statement of Transactions (SF 224) required by Treasury. The reporting cut off for the SF 224 is on the 29th day of each month. The Forest Service posts cash transactions occurring after the 29th as in transit transactions in the general ledger. Fund balance with U.S. Treasury and Cash reported in these financial statements have been adjusted to include cash receipt and disbursement transactions through September 30, 1997. Balances as of September 30, 1997 are shown below.

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U.S. FOREST SERVICE
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(dollars in thousands)

September 30, 1997

A. Fund Balance with Treasury

	<u>Entity</u>	<u>Non-entity</u>	<u>Total</u>
(1) Trust Funds	\$399,898	\$	\$ 399,898
(2) Revolving Funds	197,004		197,004
(3) Appropriated Funds	1,261,936	225,449	1,487,385
(4) Other Fund Types	<u>461,993</u>	<u>377,111</u>	<u>839,104</u>
Subtotal	2,320,831	602,560	2,923,391

B. Cash	<u>2,409</u>		<u>2,409</u>
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Total	<u>\$2,323,240</u>	<u>\$602,560</u>	<u>\$2,925,800</u>
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Reconciliation to Post-Closing Balance Per TFS 2108:

Total Fund Balance with Treasury and Cash	\$2,925,800
Minus Cash	(2,409)
Plus Balances Transferred to Other Departments	4,396
Minus In transit	(3,584)
Minus Non-Entity Fund Balance not Reported on TFS 2108	(602,560)
Minus Adjustments	<u>(239,957)</u>
Post-Closing Balance Per TFS 2108	<u>\$2,081,686</u>

The adjustments noted above were to correct timber revenue accruals at fiscal year-end and to record timber sale receipts used for payments to states and counties.

Forest Service returned \$1,939 of unused funds or expired appropriations to the US Treasury at the end of fiscal year 1997.

NOTE 3. ACCOUNTS RECEIVABLE

In accordance with the requirements of OMB Bulletin 94-01, the Forest Service reports receivables in four categories.

Entity Accounts Receivable, Federal: The Economy Act (31 U.S.C. §§1535 - 1536), the Granger-Thye Act of 1950 (16 U.S.C. 572), and other authorities authorize federal agencies to enter into agreements with other federal agencies to acquire needed expertise or to more efficiently achieve goals and objectives. The Forest Service has provided services to other agencies and Departments through programs such as the Forestry Incentives Program, the Agricultural Conservation Program and the Senior

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(dollars in thousands)

September 30, 1997

Community Service Employment Program. An allowance for doubtful accounts is not computed for receivables due from other federal agencies.

Entity Accounts Receivable, Non-Federal: Receivables in this line item are comprised mainly of reimbursements and refunds in fire prevention and suppression funds. Monies are expected from the states for firefighting-related services performed by the Forest Service. The Forest Service bills for the services rendered under joint agreements with the states.

Non-Entity Accounts Receivable, Federal: These are comprised mainly of amounts due from other Federal agencies which have been recorded in general and special fund receipt accounts, or temporarily recorded in budget clearing and suspense accounts. No allowance for doubtful accounts is computed for federal receivables. These receivables, when collected, will not be available to the Forest Service. The proceeds of receivables recorded in general and special fund receipt accounts will be deposited into the U.S. Treasury when collected.

Non-Entity Accounts Receivable, Non-Federal: These are comprised mainly of amounts due from the public and from timber sales which have been recorded in general and special fund receipt accounts, or temporarily recorded in budget clearing and suspense accounts. These receivables, when collected, will not be available to the Forest Service. Receivables recorded in general and special fund receipt accounts will be deposited into the U.S. Treasury when collected, if not used to make payments to states.

Non-federal, non-timber related receivables are reduced by an allowance for doubtful accounts of 20 percent. Non-federal, timber-related receivables (defaulted timber sales) are reduced by an allowance for doubtful accounts based on Forest Service estimates. The estimates of doubtful accounts are based on management's analysis of the accounts and on current economic conditions.

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U.S. FOREST SERVICE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS
(dollars in thousands)

September 30, 1997

The balance in the Accounts Receivable account as of September 30, 1997, consisted of the following:

<u>Description</u>	<u>Gross Accounts Receivable</u>	<u>Allowance</u>	<u>Net Accounts Receivable</u>
A. Entity Accounts Receivable			
Federal	\$47,845	\$ -	\$47,845
Non-Federal	<u>45,130</u>	<u>(9,026)</u>	<u>36,104</u>
Total Entity	<u>92,975</u>	<u>(9,026)</u>	<u>83,949</u>
B. Non-Entity Accounts Receivable			
Federal	45	-	45
Non-Federal	<u>101,801</u>	<u>(66,350)</u>	<u>35,451</u>
Total Non-Entity	<u>101,846</u>	<u>(66,350)</u>	<u>35,496</u>
Total	<u><u>\$194,821</u></u>	<u><u>\$(75,376)</u></u>	<u><u>\$119,445</u></u>

NOTE 4. OPERATING MATERIALS AND SUPPLIES, NET

As of September 30, 1997, operating materials and supplies of items held for current use consisted of:

<u>Description</u>	<u>Amount</u>
Working Capital Fund	\$24,111
Materials for Agency Use	2,328
Fire Caches	<u>41,899</u>
Total	<u><u>\$68,338</u></u>

Operating Materials and Supplies consist of: (1) materials and supplies used by the Working Capital Fund; (2) materials and supplies for agency operations; and (3) fire caches.

Materials and supplies used by the Working Capital Fund (raw materials, stock and tree seedlings)

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U.S. FOREST SERVICE
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(dollars in thousands)

September 30, 1997

are maintained to facilitate distribution of certain stock items to users who are subsequently billed commensurate with items used. Thus, costs of providing these items are recovered.

Materials for agency use consist primarily of supplies for fleet equipment rental. Materials and supplies are adjusted to reflect the results of periodic physical inventories.

Fire caches consist of fire fighting supplies reserved for emergency use. Fire cache inventories are being recognized for the first time in fiscal year 1997. In previous years, fire fighting supplies were expensed upon receipt rather than recorded as inventories. The fire caches are emergency fire fighting supplies that are maintained at nine strategic sites. Each fire cache has a pre-determined inventory stock that is brought to full pre-season levels by March 1, before each year's fire season begins. Fire caches include items such as gloves, ready-to-eat meals, pumps, generators, chain saws, and shovels. Fire cache stock is issued to the field as emergency needs dictate, with the understanding that reusable items will be returned and consumed items will be replaced or paid for as determined by the current GSA price.

Valuation Methods

Inventories in the Working Capital Fund and materials for agency use are valued based on the weighted average method. Fire Cache inventory units are valued at GSA catalog prices as of January 1, 1997. This valuation method may approximate historical costs, depending on the extent that the fire cache inventory stock is depleted each year because of the severity of the fire season.

Allowance

Management has established no allowance against these balances because operating materials and supplies that are not usable because of spoilage, obsolescence, damage, etc., are considered immaterial.

NOTE 5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, Plant and Equipment, net, consists of the following at September 30, 1997:

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U.S. FOREST SERVICE
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(dollars in thousands)

September 30, 1997

<u>Asset Class</u>	(Years) Service <u>Life</u>	Net Acquisition <u>Value</u>	Accumulated <u>Depreciation</u>	Book <u>Value</u>
Land	-	\$4,303,221	\$	\$4,303,221
Buildings, Structures, Facilities, and Lease- hold Improvements	30	1,985,654	1,303,130	682,524
ADP Software	8	179,147	78,937	100,210
Equipment	5-15	850,339	467,886	382,453
Road Components	10-50	5,805,824	2,598,492	3,207,332
Other	-	<u>13,754</u>	<u>-</u>	<u>13,754</u>
Total		<u>\$13,137,939</u>	<u>\$4,448,445</u>	<u>\$8,689,494</u>

Property, Plant and Equipment, net, consists of all real and personal property, including the 191.8 million acres of National Forest System lands, wilderness and grasslands, and roads, buildings and equipment. All property is recorded at acquisition cost, and all depreciable property is reported net of accumulated depreciation.

The Forest Service currently does not accumulate and report accurate values for all real property in its general ledger. However, real property is reported to the General Services Administration on the GSA Form 1166, Report of Real Property Owned or Leased to the United States. The report includes property received or exchanges in lieu of cash payment for timber sales. Therefore, the GSA Form 1166 is the source of information for real property shown on the Statement of Financial Position.

The Forest Service is in the process of developing better financial statement data supporting its property, plant and equipment (PP&E) line item. The Forest Service will continue to refine its PP&E data, and future account fluctuations are anticipated.

No value is recorded for public domain land because there was no carrying value associated with the land when it was transferred to the Forest Service. As of September 30, 1997, the Forest Service held 154,287 acres of public domain land. The Forest Service exchanges land with other governmental entities, corporations and private land owners to facilitate land management objectives and consolidate land boundary lines. As of fiscal year 1997, the Forest Service had exchanged 10,701 acres of National Forest System land for 40,293 acres of non-federal land. In accordance with the Federal Land Policy and Management Act of 1976 (Public Law 94-579), land received in exchanges is capitalized at the appraised value, but at no less than the recorded cost of the property exchanged, plus any additional remuneration.

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No value is accorded land exchanged for public domain land or land received in return for timber cut from public domain land. Land donated to the Forest Service is capitalized at the original cost to the donor. In accordance with OMB Bulletin No. 94-01, land is not depreciated.

NOTE 6. INTEREST RECEIVABLE

Non-Entity Interest Receivable, Non-Federal, is comprised of amounts due on Accounts Receivable for defaulted timber sale contracts. These accounts receivable have been in litigation and negotiation for several years and some have been deemed uncollectible. Interest accrued, but not reported, on uncollectible accounts receivable was \$47,134, as of September 30, 1997.

NOTE 7. OTHER ASSETS

As of September 30, 1997, Forest Service retained the following Non-Entity assets:

<u>Description</u>	<u>Amount</u>
Other Investments	\$3,511
Other	<u>7</u>
Total	<u>\$3,518</u>

Other Investments consist of securities deposited in the Federal Reserve System by timber purchasers on behalf of the Forest Service in lieu of furnishing sureties on bid, performance, and payment bonds.

NOTE 8. ACCOUNTS PAYABLE

Liabilities in the Accounts Payable, Federal, account represent the amount of monies or other resources that are likely to be paid by the Forest Service as a result of a transaction or event that has already occurred with other federal entities.

Liabilities in the Accounts Payable, Non-Federal account represent the amount of monies or other resources that are likely to be paid by the Forest Service as a result of a transaction or event that has already occurred with non-federal entities. However, no liability can be paid by the Forest Service absent an appropriation. Liabilities for which an appropriation has not been enacted are therefore classified as unfunded liabilities and there is no certainty that the appropriations will be enacted. Also, liabilities of the Forest Service can be abrogated by the government, acting in its sovereign capacity.

In fiscal year 1997, the Forest Service statistically sampled and tested year end obligations

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incurred with federal and non-federal entities. Our analysis concluded that Accounts Payable, Federal, were understated by \$8,586; and Accounts Payable, Non-Federal, were understated by \$16,862. Forest Service financial statements have been adjusted accordingly.

NOTE 9. TRUST AND DEPOSIT LIABILITIES

Trust and Deposit Liabilities, Federal, represents federal receipts that have been temporarily included in budget clearing accounts pending proper classification. The total as of September 30, 1997, is \$35,889.

Trust and Deposit Liabilities, Non-Federal, primarily consists of securities provided as surety and cash prepayments and deposits from timber purchasers. Timber purchasers deposit securities in the Federal Reserve System on behalf of the Forest Service in lieu of furnishing corporate and individual sureties on bid, performance, and payment bonds. Interest on the investments is paid directly to the timber purchasers. Timber purchasers are also required to provide cash prepayments and advance deposits prior to the actual harvest of timber. Advances remain a liability until the timber is cut.

The components of Trust and Deposit Liabilities, Non-Federal, as of September 30, 1997, are as follows:

<u>Description</u>	<u>Amount</u>
Liabilities for Timber Sales Advance	\$296,156
Securities Deposited as Surety	<u>3,511</u>
Total	<u><u>\$299,667</u></u>

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NOTE 10. ACCRUED PROGRAM LIABILITIES

Accrued program liabilities covered by budgetary resources, non-federal, consists of amounts payable for accrued payroll and benefits and payment to states and counties in accordance with Public Law 60-136 et. seq., which require the Forest Service to pay a portion of receipts from timber and other forest product sales to the states and counties where national forests and grasslands are located.

Accrued program liabilities covered by budgetary resources, non-federal, as of September 30, 1997, are shown below:

<u>Description</u>	<u>Amount</u>
Accrued Payroll and Benefits	\$ 84,214
Payments to States and Counties	<u>239,174</u>
Total	<u><u>\$323,388</u></u>

NOTE 11. UNEARNED REVENUE

Unearned Revenue, Non-Federal, consists of liabilities arising under timber sales contracts. Terms of certain timber sales contracts, allow for timber purchasers to construct roads to gain access to timber. To the extent the Forest Service has a use for the roads after contract completion, the timber purchaser is given a credit (purchaser road credit) for the value of the roads to the extent their service lives exceed the contract's duration.

The amount of the purchaser road credit given to contractors is based on a Forest Service engineering estimate made at the time of the timber sale. A purchaser road credit is established when the Forest Service accepts the road. At that time, an asset (a component of the Property, Plant and Equipment account) and a liability (the Unearned Revenue, Non-Federal, account) are recorded.

Unearned Revenue, Non Federal, is reduced commensurate with timber cut and current year revenue is recognized by the amount of the purchaser road credit used in lieu of contractor payment to Forest Service. If, when the contract is closed, all purchaser road credits have not been applied, they are canceled and the amounts are removed from the Unearned Revenue, Non-Federal, account.

Forest Service purchaser road credits as of September 30, 1997, were \$38,519.

NOTE 12. ACCRUED PROGRAM LIABILITIES

Federal law (16 U.S.C. Section 556d) provides that the Forest Service may advance money from any Forest Service appropriation to the fire fighting appropriation for the purpose of fighting fires. Upon

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requesting and receiving a supplemental appropriation for these expenses, the Forest Service must repay the appropriation from which the funds were obtained.

During fiscal years 1988 through 1997, the Forest Service incurred obligations to fight fires which were not funded in advance by appropriations. The Forest Service used unobligated balances in the Knutson-Vandenberg (K-V) Trust Fund to pay these expenses. The trust fund has not been reimbursed \$492,870 as of September 30, 1997. We have not recognized this amount as a receivable in the financial statements and will not until such time as Congress authorizes supplemental funding to repay the trust fund loan. The total due the K-V Trust Fund is also included in the Future Financing Sources line item of the Statement of Financial Position.

NOTE 13. ANNUAL LEAVE, VOLUNTARY SEPARATION PAYMENTS, AND FEDERAL EMPLOYEES COMPENSATION ACT LIABILITY

Federal Employees Compensation Act (FECA) liability is incurred as a result of workers' compensation benefits which are expected to accrue in the future. Workers' compensation benefits include the current and expected future liability for death, disability, medical and other approved costs. The U.S. Department of Labor (DOL) actuarially determines the current and expected future liability for the USDA as a whole, including the Forest Service. The Forest Service is billed annually after its claims are paid by the DOL. Payment to the DOL is deferred for two years so that the bills may be funded through the budget process. Payments to the DOL are recognized as an expense in the Statement of Operations.

The amounts of unpaid FECA billings constitute the accrued FECA payable. Accrued FECA payable is also included in the Future Financing Sources line item of the Statement of Financial Position.

Public Law 104-180, dated August 6, 1996, authorized USDA to provide voluntary separation incentive payments to any employee to the extent necessary to eliminate positions and functions identified in the agency's strategic plan. The authority is effective until September 30, 2000. FS estimated the liability for buyouts during FY 1998 to be approximately \$32.9 million. No estimates are available for FY 1999 or FY 2000.

The total annual leave, voluntary separation payments and components of accrued FECA payable as

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of September 30, 1997 are as follows:

<u>Description</u>	<u>Amount</u>
Current Liability	\$ 33,910
Expected Future Liability	316,175
Voluntary Separation Payments	32,900
Annual Leave	<u>144,224</u>
Total Annual Leave and FECA Liability	<u>\$527,209</u>

NOTE 14. CONTINGENCIES AND COMMITMENTS

The Forest Service pays small tort claims out of its own funds and these costs are reflected as expenses or as liabilities in our Statement of Financial Position and Statement of Operations (and Changes in Net Position). However, many other types of legal actions which affect the Forest Service and exceed twenty-five hundred dollars fall under the Federal Tort Claims Act and are paid from the Claims, Judgements and Relief Acts Fund maintained by the Department of Treasury. Since the Forest Service is not required to reimburse the fund for payments for claims made on behalf of the Service, judgement fund payments relating to claims against the Forest Service are not reflected in these financial statements. According to the United States General Accounting Office, \$15,196 was paid from the fund to settle actions against the Forest Service during fiscal year 1997.

Other types of legal actions may be paid out of Forest Service funds. As of December 31, 1997, Forest Service management was aware of the following contingencies, which take the form of pending litigation, and asserted and unasserted claims. It is impossible to predict with certainty the outcome and amount of liability, if any, resulting from these actions.

Environmental Contingencies

Under the provisions of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), the Clean Water Act (CWA), and the Resource Conservation and Recovery Act (RCRA), the Forest Service anticipates cleaning up hazardous materials on Forest Service lands. The total estimated is \$2,900,000.

This estimate is very tentative, and also sensitive to changes in remedy standards and new technology. The site discovery and assessment process will continue for several more years; and, the actual number of sites discovered and cleanup costs will continually change as the process evolves. This estimate also does not reflect anticipated cost recovery from or contribution to cleanup costs by

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responsible parties because the amounts are highly speculative. There is a reasonable possibility, however, that some of this cleanup cost will be paid by parties other than the Forest Service.

Pending Litigation and Unasserted Claims

The Forest Service is involved in litigation and claims concerning the denial of a mining lease, timber sale stumpage rates, cancellation of timber contracts, termination of special use permits, and other matters. Some of the litigation associated with these matters is anticipated to be protracted. According to the Office of the General Counsel, if the claimants are successful in all of these actions, a scenario which will not necessarily occur, the Forest Service could be responsible for paying damages of at least \$297,686. These damages represent claims in excess of \$10 million only.

NOTE 15. NET EQUITY OF THE U.S. GOVERNMENT

Net Position presented on the Statement of Financial Position consists of the following:

Unexpended Appropriations: This line item represents amounts of budget authority that are either unobligated (and have not lapsed, been rescinded or withdrawn) or obligated but not yet expended.

Invested Capital: The Invested Capital line item consists of amounts invested in property, plant and equipment, and other capitalized assets, such as leasehold improvements. Reductions in the invested capital account occur as a result of the depreciation, amortization or disposition of capital assets.

Donated Capital: This line item represents amounts of contributed cash, services, or property into the Forest Service funds from other entities.

Cumulative Results of Operations: The Cumulative Results of Operations line item represents the balance of net income and expense resulting from working capital fund operations from inception of the fund to date.

Future Financing Sources: This line item reflects liabilities which are not covered by budgetary resources. These liabilities include FECA, firefighting advances, accrued annual leave, and voluntary separation payments.

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Net Position as of September 30, 1997, consists of the following:

	<u>Revolving Funds</u>	<u>Trust Funds</u>	<u>Appropriated Funds</u>	<u>Total</u>
Unexpended Appropriations:				
(1) Unobligated				
a. Available	\$(187,774)	\$208,291	\$1,173,686	\$1,194,203
b. Unavailable	169,335	(54,435)	37,368	152,268
(2) Undelivered Orders	73,279	30,658	449,791	553,728
(3) Special Fund Receipts			63,909	63,909
Invested Capital	(15,667)	62,597	8,322,486	8,369,416
Donated Capital	103			103
Cumulative Results of Operations	<u>417,779</u>	_____	_____	<u>417,779</u>
Subtotals	457,055	247,111	10,047,240	10,751,406
Future Financing Sources	_____	_____	<u>(1,020,079)</u>	<u>(1,020,079)</u>
Totals	<u>\$457,055</u>	<u>\$247,111</u>	<u>\$9,027,161</u>	<u>\$9,731,327</u>

Any negative balances shown above for unobligated appropriations should not be interpreted as an over obligation of funds.

The negative balances in the Revolving Fund occur because of a combination of factors originating in the apportionment process and procedures used during year end closing of general ledger accounts. When anticipated reimbursements exceed actual reimbursements, a negative balance is created in certain preclosing accounts. During the closing process the amounts in the preclosing accounts are brought forward to the total unobligated balance.

In the case of the negative Trust Fund balance, this amount was caused by intra-agency

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transactions involving payment received from the Cooperative Work Knutson-Vandenberg (CWKV) Fund for firefighting purposes in fiscal year 1996.

NOTE 16. REVENUES FROM SALES OF GOODS AND SERVICES, NON-FEDERAL

The Revenues from Sales of Goods and Services, Non-Federal is derived from the sale of timber and minerals, and from fees collected for the use of National Forest land for recreational special uses, grazing, and other permitted activities.

The U.S. Department of Interior's (DOI) Bureau of Land Management, pursuant to authority granted under the Minerals Leasing Act of 1920 (*30 U.S.C. §§ 181 et. seq.*), the Mineral Leasing Act for Acquired Lands, (*30 U.S.C. §§ 351-359*), the Geothermal Act of 1970, (*30 U.S.C. §§ 1001 et. seq.*), and various other Acts covering specific minerals, issues leases and oversees the exploration, development, production and transportation of federally owned leasable minerals within the National Forest System.

These Acts require the DOI to obtain the consent of the Forest Service before leasing the minerals on Forest Service land. The collection of rents and royalties received from these leases falls under the jurisdiction of the U.S. Department of Interior's Minerals Management Service (MMS). Receipts collected by MMS from public domain lands are recorded in the MMS Treasury accounts and are not recorded in the Forest Service financial statements.

The DOI now collects receipts which were collected by the Forest Service until fiscal year 1993 and makes payments to the States directly. Public Law 102-486, section 2506, directed the DOI to collect receipts from minerals sold under the Minerals Leasing Act for Acquired Lands and make payments to the States at the rate prescribed in the Federal Oil and Gas Management Act of 1982.

Revenues are posted to NFC's central accounting system (CAS) after reduction (or writeoff) by field offices for amounts that such field offices do not expect to collect. Also, writeoffs against accounts receivable are not posted to the Forest Service general ledger, because NFC's CAS cannot match individual writeoffs against specific accounts receivable. The accrual basis of accounting requires that gross revenues and an independent provision for losses be recognized in the financial statements. Thus, the Forest Service accounting methodology may substantially understate two complementary financial statement account balances--Revenues From Sales of Goods and Services, Non-Federal, and Provision for Losses. Time and resource constraints prohibit reconstruction of reliable account balances.

NOTE 17. OTHER REVENUES

Other revenue for the year ended September 30, 1997, totaled \$25,056 and consisted of receipts

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from the collection of fines and penalties, rents collected from employees who live in Forest Service quarters, gifts and contributions, gains on the disposition of assets, and other transactions that did not involve the sale of goods and services to the public or other Federal entities

NOTE 18. OTHER FINANCING SOURCES

For the year ending September 30, 1997, Other Financing Sources consisted of the following imputed financing charges paid by other entities on behalf of the Forest Service:

<u>Description</u>	<u>Amount</u>
Employee Benefit Expense	\$151,039
Judgement Fund Payment	<u>140,000</u>
Total	<u><u>\$291,039</u></u>

The imputed financing charges for the employee benefits represent the difference between the employer contributions and the employer's expense for pensions, post-retirement life insurance and health insurance. The imputed financing charges for the judgement fund payment represent the amount of a settlement agreement which was paid by Treasury. See Note 22 - Extraordinary Items, for additional information on this payment.

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NOTE 19. OPERATING/ PROGRAM EXPENSES

Operating expenses for the year ended are shown below by major object class. Expenses shown below exclude certain expenses required by OMB Bulletin 94-01 to be reported on other line items of the Statement of Operations and Changes in Net Position.

Operating expenses by major object class for the year ending September 30, 1997 are as follows:

Personnel Services and Benefits	\$1,904,243
Travel and Transportation	95,641
Rental, Communication and Utilities	131,963
Printing and Reproduction	10,201
Contractual Services	606,966
Supplies and Materials	187,473
Grants, Subsidies and Contributions	439,042
Insurance Claims and Indemnities	5,124
Equipment	113,201
Structures	37,251
Miscellaneous	<u>2,909</u>
Total	<u><u>\$3,534,014</u></u>

Per Office of Management and Budget (OMB) Circular 94-01, the above categories represent major expenses used for various programs by the Forest Service. The National Forest System program expenses are related to managing and maintaining 158 National Forests and 20 National Grasslands encompassing 191.8 million acres. Included are the annual costs associated with minerals, range management, fish and wildlife, soil and water, recreation, fire fighting, timber growth, and timber sales activities. National Forest System expenses also include land use planning and plan implementation, boundary location and marking, insect and disease control, law enforcement, and fire fighting activities. Miscellaneous Expenses, (\$2,909), consist of minor budget object classes. The minor classes are:

4300	Interest Payments	126
5100	Depreciation of Personal Property	1,654
3300	Investments/Loans	(2)
4400	Refunds to Public	1,067
4500	Cooperative Agreements/Contracts	<u>62</u>
	Total	2,909

Excluded from the account are all costs related to the National Forest System which are capitalized, such as inventories, equipment, land, buildings, and roads.

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Research expenses are incurred by the Forest Service in developing scientific and technical knowledge to enhance and protect the economic productivity and environmental quality of the nation's 1.6 billion acres of forests and associated rangelands. Priority research programs include assessing the effects of acid rain on forests and wetlands, controlling pest outbreaks, studying the effects of forest use on wildlife, and developing fire behavior protection systems.

State and Private Forestry expenses stem from working with State and private landowners to manage and protect the nation's private forested and associated range and watershed lands. State and private forestry expenses include those incurred for fire prevention and pest management in State and private forests, resource conservation and development, and other cooperative projects.

Human Resource Program expenses are incurred by the Forest Service in providing job opportunities and training for youths, the unemployed, the economically disadvantaged, the disabled and the elderly, while carrying out high-priority conservation work. Among the programs carried out by the Forest Service are the Senior Community Service Employment Program and, under an agreement with the DOL, the operation of 18 Job Corps Civilian Conservation Centers.

The International Forestry Program expenses are incurred in promoting scientific natural resource management, assessing the impact of global climate change on forests, responding to the threat of tropical deforestation, and addressing the needs of developing countries for sound resource management. Some program activities are partially reimbursed by the U.S. Agency for International Development through the USDA Office of International Cooperation and Development.

Payments to states and counties are amounts paid pursuant to Public Law 60-136 (*16 U.S.C. §500 et. al.*) which requires the Forest Service to make payments from moneys received from the harvest of timber, sales of other forest products, and fees charged for the use of the National Forests and Grasslands. These payments are made to the States and counties where the National Forests and Grasslands are located. These distributions to the States and counties reflect Congress' intent to recognize a national interest in education and road building in the recipient areas.

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NOTE 20. PROVISION FOR LOSSES

Non-federal, non-timber related receivables are reduced by an allowance for doubtful accounts of 20 percent of gross receivables. Non-federal, timber related receivables are reduced by an allowance for doubtful accounts based on Forest Services analysis of the accounts and on current economic conditions. Reported receivables declined, resulting in a reduced allowance amount required. Forest Service management reduced the allowance and established a (\$8,788) provision for loss for the year ended September 30, 1997.

Revenues are posted to NFC's CAS after reduction (or writeoff) by field offices for amounts that such field offices do not expect to collect. Also, writeoffs against accounts receivable are not posted to the Forest Service general ledger, because NFC's CAS cannot match individual writeoffs against specific accounts receivable. The accrual basis of accounting requires that gross revenues and an independent provision for losses be recognized in the financial statements. Thus, the Forest Service accounting methodology may substantially understate two complementary financial statement account balances-- Revenues From Sales of Goods and Services, Non-Federal, and Provision for Losses. Time and resource constraints prohibit reconstruction of reliable account balances.

NOTE 21. OTHER EXPENSES

Other Expenses for the year ending September 30, 1997, are comprised of losses on the disposition of assets, FECA expense, and interest expense.

<u>Description</u>	<u>Amount</u>
Loss on Disposition of Assets	\$ 721
FECA Expense	33,909
Interest Expense	748
Total	<u>\$35,378</u>

NOTE 22. EXTRAORDINARY ITEMS

On February 21, 1997, the United States and Louisiana Pacific, Ketchikan Pulp Company's (KPC) parent corporation, entered into a settlement agreement to resolve years of legal proceedings concerning timber sales in the Forest Service's Alaskan Region. The Government agreed to pay KPC \$135 million to resolve all of KPC's contract claims against the Forest Service. Upon KPC's compliance with all the terms of the settlement agreement, the Government agreed to pay KPC an additional \$5 million.

The settlement amounts were probable and estimable as of September 30, 1997, and were

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paid from the Treasury Judgement Fund during fiscal year 1997 on behalf of the Forest Service. In accordance with the Federal Accounting Standards Advisory Board Interpretation No. 2, "Accounting for Treasury Judgement Fund Transactions", Forest Service recognized the expense and other financing source for \$140 million, the full amount of the loss.

NOTE 23. ADJUSTMENTS

Adjustments to net position are as shown below:

<u>Description</u>	<u>Amount</u>
Recognition of fire caches previously expensed	\$41,898
Fiscal year 1996 PRC revenue earned, not recorded	41,463
Fiscal year 1995 PRC revenue earned, not recorded	79
Reduce current expense for fiscal year 1996 (Fire Cache Restocking)	(1,680)
Bad debt expense, fiscal year 1996 non-entity accounts receivable	(15,096)
Bad debt expense, fiscal year 1996 defaulted timber sales	(61,200)
Bad debt expense, fiscal year 1996 entity accounts receivable	(7,991)
Fiscal year 1996 timber revenue	<u>127,426</u>
Total	<u>\$124,899</u>

NOTE 24. NON-OPERATING CHANGES

Non-Operating Changes consist of increases or decreases in the components of net position that are not reported on the Statement of Operations. Examples are transfers from or to other agencies, donations, and other increases and decreases in net position. The Non-Operating Changes account for the year ended September 30, 1997 consisted of the following.

<u>Description</u>	<u>Amount</u>
Increases:	
Transfers In	\$ 223
Donations Received	44,107
Other Increases	<u>14,224,791</u>
Total Increases	\$14,269,121
Decreases:	
Transfers Out	\$ 224
Other Decreases	<u>11,946,664</u>

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Total Decreases	<u>\$11,946,888</u>
Total	<u><u>\$2,322,233</u></u>

Amounts in the Other Increases and Other Decreases line items were derived from an analysis (beginning balances are subtracted from ending balances per the pre-closing trial balances) by NFC of certain Standard General Ledger (SGL) account balances. NFC's analysis is intended to conform to the crosswalk for the Non-Operating Changes line item in accordance with OMB Bulletin 94-01, page 88. The SGL account names and numbers involved are:

<u>Account Name</u>	<u>SGL Account No.</u>
Appropriated Capital	3100
Capital Investments	3210
Transfers-in from Others without Reimbursement	3220
Transfers-out to Others without Reimbursement	3230
Cumulative Results of Operations	3310
Donations and Other Items	3400
Future Funding Requirements	3501

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